Supreme Court, U.S.
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No. _____

In The

Supreme Court of the United States

ESTHER L. GAYMAN,

Petitioner,

v.

PRINCIPAL FINANCIAL SERVICES, INC.,
Principal Financial Group, Inc., and
Principal Life Insurance Company,

Respondents.

On Petition For A Writ Of Certiorari To The United States Court Of Appeals For The Seventh Circuit

PETITION FOR WRIT OF CERTIORARI

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QUESTIONS PRESENTED

1. In connection with the conversion of Principal Mutual Life Insurance Company from a mutual to a stock company, could the Seventh Circuit disregard as outdated *Phillips Petroleum Company v. Jenkins*, 297 U.S. 629, 634-35 (1936), which sets forth the rule that the Takings Clause and Contract Clause prohibit the use of a state's reserved power "to take property without just compensation . . . or to destroy or impair any vested property right?" The Seventh Circuit construed *American Mfrs. Mutual Ins. Co. v. Sullivan*, 526 U.S. 40 (1999) and other recent cases as *sub silentio* overruling the more specific "reserve power" law stated in *Phillips Petroleum*.

2. Does the "per se" Takings Clause analysis of *Brown v. Legal Foundation of Washington,* 123 S.Ct. 1406 (2003), apply when, as here, a private actor (a mutual insurer) exercises the state reserved powers to force the owners of property (the mutual policyholders) to relinquish their property rights in a forced sale under a state conversion law, where the mutual insurer otherwise lacked the contractual right to take the mutual policyholders' property?

PARTIES

Petitioner, Esther L. Gayman, was a participating policyholder of Principal Mutual Life Insurance Company.

Respondents are Principal Financial Services, Inc., Principal Financial Group, Inc., and Principal Life Insurance Co., the surviving corporate entities after Principal Mutual's demutualization conversion.

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OPINIONS BELOW

The opinion of the United States Court of Appeals for the Seventh Circuit (App. 1-4) is reported at *Gayman v. Principal Financial Services, Inc.*, 311 F.3d 851 (7th Cir. 2002). Its denial of rehearing and rehearing *en banc* (App. 9) is unreported. The opinion of the district court (App. 5-8) is reported at 2002 WL 598527 (N.D. Ill. April 18, 2002).

JURISDICTION

The court of appeals' judgment was entered on November 22, 2002. Petitioner's timely-filed petition for rehearing and rehearing *en banc* was denied on December 17, 2002. Appendix C. On February 25, 2003, Justice Stevens extended Petitioner's time to file a petition for a writ of certiorari to and including April 21, 2003. This Court's jurisdiction is invoked under 28 U.S.C. § 1254(1).

CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

1. The Takings Clause of the Fifth Amendment, U.S. Const. amend. V, provides: "nor shall private property be taken for public use, without just compensation."

2. 42 U.S.C. § 1983 provides: "Every person who, under color of any statute, ordinance, regulation, custom, or usage, of any State or Territory or the District of Columbia, subjects, or causes to be subjected, any citizen of the United States . . . to the deprivation of any rights, privileges or immunities secured by the Constitution and

laws, shall be liable to the party injured in an action at law . . . "

3. The Contract Impairment Clause of Article 1 of the Constitution, U.S. Const. art. 1, § 10, provides: "No state shall . . . pass any Bill of Attainder, ex post facto Law, or Law impairing the Obligation of Contracts . . . "

4. Iowa Const. art. 8, § 12 provides: "the general assembly shall have power to amend or repeal all laws for the organization or creation of corporations . . . " Appendix F.

5. Iowa Code § 491.39. Legislative Control; Appendix E.

6. Iowa Code § 508B, "Conversion From Mutual Company to Stock Company." Appendix D.

STATEMENT OF THE CASE

In 1879, the State of Iowa ("the State") granted a charter authorizing Bankers Life Company to operate as a mutual benefit concern. App. 37. In 1969 the Bankers Life Articles of Incorporation were amended and substituted and Bankers Life changed its name to Principal Mutual Insurance Company ("Principal") in 1986.[1] App. 37. Principal and its predecessors issued and delivered

[1] Principal refers to the pre-conversion entity, a mutual company, and the post-conversion entities Principal Life Insurance Company, an Iowa domestic stock life company, Principal Financial Group, Inc., a Delaware business corporation, and Principal Financial Services, an Iowa business corporation, unless stated otherwise.

"participating" contracts of insurance premised upon the expectation that it would operate as a mutual life insurance company, including to Petitioner and other "Members." App. 33.

Pursuant to its reserved power, IA Const. art. 8, § 12, the State enacted a law authorizing domestic mutual life insurance companies to convert to stock life companies in 1985. Iowa Code § 508B (the "Conversion Law"). Appendix D. On March 31, 2001, Principal Mutual's Board adopted a Plan of Reorganization (the "Plan") and sought approval pursuant to the Conversion Law. The Plan proposed to convert Principal Mutual from a mutual holding company with a stock subsidiary, in which the enterprise was mutually owned, into a stock holding company, owned by shareholders. The Plan proposed to pay cash, policy credits or common stock in Principal Financial Group ("PFG"), the new parent company, to its policyholders ("Members") in exchange for their membership interests. App. 85-88. A public hearing and vote were held. Only 30% of Principal's members voted, with a majority of voters voting in favor. App. 80-81. On August 28, 2001, the Commissioner approved the Plan. App. 85-88. The Plan was implemented on October 26, 2001, when Principal conducted an IPO.

On September 27, 2001, Petitioners filed a Complaint seeking damages by reason of the conversion. The Complaint alleges that, because Principal obtained State authorization and power to take Members' contracts, Principal's conduct was "state action" that deprived Members of rights secured by the Takings Clause (Counts I-II), the Commerce Clause (Count III) and the Contracts Clause (Counts IV-V). App. 6, 31-63.

On April 18, 2002, the District Court entered a decision granting Principal's Motion To Dismiss pursuant to Fed.R.Civ.P. 12(b). Appendix B at App. 5-8. The District Court held that the Complaint failed to allege "state action," as required by 42 U.S.C. § 1983. The Seventh Circuit Court of Appeals affirmed, holding that the Complaint failed to allege action "under the color of state law" under this Court's decisions in *Jackson v. Metropolitan Edison Co.*, 419 U.S. 345 (1974) and *American Mfrs. Mutual Ins. Co. v. Sullivan*, 526 U.S. 40 (1999). Appendix A at App. 1-4.

REASONS FOR GRANTING THE PETITION

Certiorari should be granted to resolve a conflict of authority among federal courts of appeal with decisions of this Court which affects the property rights of tens of millions of mutual life insurance policyholders. This Court has long held that the protections of the Takings and Contracts Clauses prevent a corporation from using state "reserved power" to take the contracts made by the corporation with private parties without just compensation in order to alter or amend the form and powers of the corporation. *Phillips Petroleum Co. v. Jenkins,* 297 U.S. 629 (1936) and *Coombes v. Getz*, 285 U.S. 434 (1932). The Sixth Circuit applied this constitutional limitation in *Ohio State Life Ins. Co. v. Clark*, 274 F.2d 771 (6th Cir. 1960).

However, the Seventh Circuit here and the Second Circuit in *Tancredi v. Metropolitan Life Ins. Co.*, 316 F.3d

308 (2nd Cir. 2003), implicitly held that these constitutional limitations no longer apply.[2] The Second and Seventh Circuits construed *American Mfrs. Mutual Ins. Co. v. Sullivan*, 526 U.S. 40 (1999), and other more recent "state action" cases to have, *sub silentio,* overruled the more specific "reserve power" law recognized in *Phillips Petroleum* and *Coombes*. These precedents have not been overruled by this Court and, therefore, continue to provide the applicable rules of decision. Only this Court may overrule its precedents. *Thurston Motor Lines, Inc. v. Jordan K. Rand, Ltd.*, 460 U.S. 533 (1983).

In addition, a mutual insurer who utilizes state reserved power in a statutory conversion to forcibly take property (here the mutual life insurance contracts), in order to effectuate the conversion, engages in a "per se" taking within the meaning of *Brown v. Legal Foundation of Washington*, 123 S.Ct. 1406 (2003). The Seventh Circuit's refusal to apply this Court's "per se" takings analysis conflicts with *Brown*.

The constitutional questions presented affect the property of tens of millions of policyholders of Principal and other companies. The growth of mutual life insurance has been exponential since the first mutual company was formed in 1843. Hansman, *The Organization of Insurance Companies, Journal of Law, Economics and Organization*, Vol. 1, No. 1, p. 134 (Fall 1985). Until recently, the mutual was a predominant form of corporate organization in the life insurance industry. By the end of 1999, thirty-six

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[2] A Petition for Writ of Certiorari is being contemporaneously filed in *Tancredi v. Metropolitan Life Ins. Co.*

percent of all life insurance policies nationwide were held in mutual insurance companies, which are owned by the policyholders. *See* Smallenberger, *Restructuring Mutual Life Insurance Companies: A Practical Guide Through the Process*, 49 Drake L. Rev. 513, 517 (2001).

The mutual form of corporate organization, however, is in the process of being dismantled through statutory conversions. Within the last 20 years, many states, including Iowa, have enacted new laws, or amended existing laws, authorizing procedures by which mutual life insurance companies may convert to stock life companies. *See* Racz, *No Longer Your Piece of the Rock: The Silent Reorganization of Mutual Life Insurance Companies*, 73 N.Y.U. L. Rev. 999, 1102-1103 (June 1998). Forty-five states presently have some form of mutual statutory conversion law. Smallenberger, *supra* at 526-527. Numerous mutual insurers have already demutualized, and most, if not all, of the others are expected to follow suit using these statutes. *Id.* at 517.

I. The Seventh Circuit's Decision Is In Direct Conflict With *Phillips Petroleum*

A. *Phillips Petroleum* Requires Application Of The Takings And Contracts Clauses To A Corporate Reorganization Under A State's Reserved Power

This Court in *Phillips Petroleum*, 297 U.S. at 634-35, restated longstanding precedent that the use of state authority enabling a change in corporate form under a state's reserved power is limited by the Takings Clause and Contracts Clause of the United States Constitution:

> The reserved power is not unlimited and cannot be exerted to defeat the purpose for which the corporate powers were granted, *or to take property without just compensation . . . or to destroy or impair any vested property right.*

(emphasis added); *see also Id.* at 536 n.5 (listing cases applying this rule) and *Coombes v. Getz,* 285 U.S. 434, 441-42 (1932) ("The authority of a state under the so-called reserved power is wide; but is not unlimited . . . the interrelations of state, corporation, and stockholders may be changed; but neither vested property rights nor the obligation of contracts of third persons may be destroyed or impaired.") (citations omitted). This rule derives from *Dartmouth College v. Woodward*, 4 Wheat. 518, 4 L.Ed. 629 (1819), which held that a state's charter creates a public contract protected by the Contracts Clause. As a result of *Dartmouth College*, many states adopted constitutional provisions, as did Iowa, reserving the power to alter, amend or repeal corporate charters. *Looker v. Maynard*, 179 U.S. 46, 51 (1900). By enactment of this "reserved power," the state "contractually" reserved the right to subsequently amend a charter because the "reserved power" would then be implied by law in all corporate charters.

This Court, however, also recognized that the reserved power to alter or amend charters is not absolute, and is limited only to the extent it "will not defeat or substantially impair the object of the grant, or any right vested under the grant . . . " *Phillips Petroleum*, 297 U.S. at 635; *Looker*, 179 U.S. at 52. *Cf., Polk v. Mutual Reserve Fund*, 207 U.S. 310, 325-26 (1907) (holding that where the legislature does not change the essential character of the charter, alteration is proper); *Wright v. Minnesota Mutual*

Life Ins. Co., 193 U.S. 657, 663-64 (1904) (same). Thus, the Takings Clause and Contracts Clause apply to the exercise of reserved power when a change in corporate form would destroy contracts made by the corporation. Even then, the state power of eminent domain must be used to accomplish the change, provided, of course, that just compensation is paid. *See West River Bridge Co. v. Dix*, 47 U.S. 507, 531 (1848) ("No state, it is declared, shall pass any law impairing the obligation of contracts; yet . . . in every political sovereign community there inheres necessarily the right and the duty of . . . protecting and promoting the interests and welfare of the community at large. . . . This power . . . denominated the '*eminent domain*' of the State is paramount to all private rights vested . . . ") (emphasis in original).[3]

The Sixth Circuit in *Ohio State Life Ins. Co. v. Clark,* 274 F.2d 771 (6th Cir. 1960) correctly applied the case law of this Court. In *Ohio State Life,* an attempt was made to alter the charter of an insurance company in a way that would have destroyed the rights of certain "mutual plan

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[3] *See Lord v. Equitable*, 194 N.Y. 212, 87 N.E. 443, 448 (1909) ("When the Legislature has created a corporation and has given it power to acquire property, it cannot take away the property so acquired without providing for compensation . . . No reservation, for instance, could authorize a law giving to policyholders the capital stock belonging to the stockholders."). V. Morawetz, *Private Corporations* 1050 (1886), quoted in Taylor, *Evolution of Corporate Combination Law: Policy Issues And Constitutional Questions*, 76 N.C. L. Rev. 687, 1014 (1998) ("The property and privileges belonging to individual members of a corporation are subject to *the power of eminent domain* . . . and in the exercise of this power *a state* may enable any portion of the shareholders in a corporation to dissolve their association . . . *upon making just compensation to such shareholders as are not willing to accept the change* . . . ").

policyholders" to the surplus. *Id.* at 775. Relying on *Coombes v. Getz,* 285 U.S. at 441-42, the Sixth Circuit held that the reserved power to amend the charter was not so broad as to allow the company to destroy the vested rights of its mutual policyholders: "In our opinion, the proposed amendment by the stockholders, acting under the power of corporate amendment conferred by the legislature, would be an impairment of the contract obligations of the corporation running to appellees." *Id.* at 779.[4]

Phillips Petroleum and *Coombes* are the law today because they have never been overruled by this Court.

B. The Decision Of The Seventh Circuit Erroneously Eliminates The Takings And Contracts Clauses Restrictions On The Exercise Of State Reserved Power

The use of a statutory conversion by Principal to effect the conversion of a state charter from a mutual to a stock company constitutes the exercise of reserved power and, therefore, "state action," because the exercise of this state power was used, as alleged, to take vested mutual life insurance contracts. "State action" constitutes conduct "fairly attributable" to the state. *Lugar v. Edmondson*, 457 U.S. 922, 937 (1982). A "state actor" is one who *exercises a right or privilege created by the state* or engages in conduct imposed by the state or by a person for whom the state is responsible. *Id.* In a statutory conversion, such as here,

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[4] State courts apply this rule in mutual to stock conversions. *Huber v. Martin*, 127 Wis. 412, 105 N.W. 1031, 1037-1039 (1906) and *Carlton v. Southern Mut. Ins. Co.*, 72 Ga. 371 (1884).

the mutual insurer's use of reserved power embedded in statutory law is the exercise of a right or privilege created by the state.

A mutual insurer's conduct is "fairly attributable" to the state where the mutual insurer, with state authorization, exercises a right under the state's reserve power, as in *Phillips Petroleum*, to "defeat or substantially impair the object of the grant, or any right vested under the grant . . . " *Phillips Petroleum*, 297 U.S. at 635. Here, where a mutual insurer exercises reserved power to take vested contractual rights of policyholders to the surplus, then the mutual insurer is exercising state action. Exercise of reserve power can occur by amending the law under which a charter was taken, or by the creation of authority for the corporation to make the change itself. *Lord v. Equitable*, 194 N.Y. 212, 227, 87 N.E. 443, 448 (1909). Here, the State of Iowa amended its insurance law in 1985, and periodically thereafter, to provide the procedures by which a mutual insurer could exercise reserved power of the State to change its corporate form and powers. Under the Conversion Law, a mutual insurer utilizes Iowa's "reserved power" by creating and formulating a plan of conversion pursuant to the statutory procedure, subject to approval of the Commissioner of Insurance. Appendix D.

The Seventh Circuit, by focusing only on the necessity of state approval under the Conversion Law, concluded that the Takings Clause no longer applies to a state's exercise of reserve power. The Seventh Circuit recognized that Petitioner asserted that the conversion of Principal pursuant to the Conversion Law violated their rights under the Takings and Contracts Clauses. *Gayman*, 311 F.3d at 852. Appendix A at App. 3. To determine whether these constitutional provisions applied, the Second Circuit

only examined this Court's decisions in a recent line of "state action" cases, including *American Mfrs. Mutual Ins. Co.*, all of which construed the element of "state action" under 42 U.S.C. § 1983. *See also Jackson v. Metropolitan Edison Co.*, 419 U.S. 345, 352-353 (1974); *Flagg Bros., Inc. v. Brooks*, 436 U.S. 149, 164 (1978) and *Blum v. Yaretsky*, 457 U.S. 991 (1982). From these cases, the Seventh Circuit concluded that neither the fact of extensive state regulation nor the need to obtain official approval turn private action into public action. *Gayman*, 311 F.3d at 853. Appendix A at App. 3.

The cases applied by the Seventh Circuit, however, neither involved nor addressed an exercise of "reserved power." Instead, *American Mfrs.* only involved the right of insurance companies to suspend benefits under a state's workers' compensation law. *Id.*, 526 U.S. at 45. *Jackson* only involved the right of a private electric company to terminate its customer's electrical service pursuant to a general tariff filed with the state public utility commission. *Id.*, 419 U.S. at 346. *Flagg Bros.* only involved the right of a warehouseman to sell goods entrusted to him for storage under the New York Uniform Commercial Code. *Id.*, 436 U.S. at 151. *Blum* only involved the right of a nursing home to discharge or transfer patients pursuant to certain federal regulations. *Id.*, 457 U.S. 991. Clearly, these cases did not address, let alone overrule, the precedent underlying *Phillips Petroleum.*

A second element of state action examines whether a particular person or entity has conducted itself as a "state actor." *Lugar,* 457 U.S. at 937. This element requires a careful examination of the "specific conduct" alleged by the plaintiff. *Id.* The Seventh Circuit also erred by not focusing on the specific conduct about which Petitioner

complained. In the statutory conversion here, the specific conduct alleged is that *the mutual insurer's use of reserved power under a statutory conversion procedure constitutes a taking of property without just compensation*. Given this alleged conduct, a court must examine whether the three elements of a Takings violation exist, including that (1) a "property interest" exists; (2) a "taking" of that property occurred, and (3) there was a failure to pay "just compensation" upon the taking. *See Phillips v. Washington Legal Foundation*, 524 U.S. 156, 164 (1998). If these elements exist, *a fortiori*, "state-action" under either the Fourteenth Amendment or § 1983 must exist because conduct which satisfies the state-action requirement of the Fourteenth Amendment constitutes action "under color of state law" under § 1983. *Brentwood Acad. v. Tennessee Secondary School Athletic Assoc.*, 531 U.S. 288, 295, n.2 (2001).

This Court's recent "state action" cases relied upon by the Seventh Circuit have not replaced the reserved power law stated in *Phillips Petroleum*. As this Court observed in *Jackson*, 419 U.S. at 352-53, "If we were dealing with the exercise by Metropolitan of some power delegated to it by the State which is traditionally associated with sovereignty, such as eminent domain, our case would be quite a different one." The exercise of reserved power delegated by a conversion law likewise implicates the power to take property and, therefore, gives rise to state action.[5]

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[5] In recognition of these constitutional restrictions, appraisal statutes were enacted to provide a method of providing full compensation to contract holders injured by a corporate charter amendment. *See, e.g.*, Calio, *New Appraisals Of Old Problems: Reflections On The Delaware Appraisal Proceeding*, 32 Am. Bus. L.J. 1, 8-13 (1994) (tracing

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II. The Decision Of The Seventh Circuit Is In Direct Conflict With This Court's Decision in *Brown v. Legal Foundation of Washington*, 123 S.Ct. 1406 (2003)

The Seventh Circuit's decision directly conflicts with *Brown v. Legal Foundation of Washington*, 123 S.Ct. 1406 (2003). In *Loretto v. Teleprompter Manhattan CATV Corp.*, 458 U.S. 419 (1982) and *Yee v. City of Escondido*, 503 U.S. 519, 527 (1992), this Court explicitly recognized that government authorization that allows the taking of one's property by another constitutes conduct protected by the Takings Clause. A "physical" taking occurs where the government authorizes a physical occupation or taking of property by a third person or itself. *See Yee* at *Id. Loretto*, 458 U.S. at 426. Recently, this Court held that the use of government authority to transfer a contractual right constitutes a type of "per se" taking:

> We agree that a *per se* approach is more consistent with the reasoning in our *Phillips* opinion than *Penn Central*'s ad hoc analysis. As was made clear in *Phillips,* the interest earned in the IOLTA accounts "is the 'private property' of the owner of the principal." 524 U.S., at 172, 118 S.Ct. 1925. If this is so, the transfer of the interest to the Foundation here seems more akin to the occupation of a small amount of rooftop space in *Loretto.*

Brown, 123 S.Ct. at 1419.

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origins of appraisal rights). Mutual members have no comparable statutory rights.

The Seventh Circuit erred by not applying the mandated three-part Takings analysis required by *Phillips v. Washington Legal Foundation*, 524 U.S. 164 (1998). The three elements of a Takings claim (a property interest, a taking, and the failure to pay just compensation) exist with respect to a statutory conversion where, as here, it is alleged that the mutual policyholders' contractual rights were not fully compensated in the course of the conversion proceedings. In "per se" takings cases a "clear rule" of just compensation applies. *See Yee*, 503 U.S. at 522-523. Here, as more fully discussed below, a property interest does exist. Second, a "per se taking" occurs in a statutory conversion because the components of the mutual insurance contracts are abrogated by government power, not private consent. A "per se" taking results when the powers to possess, use and control property are destroyed. *Loretto*, 458 U.S. at 434-35; *Yee*, 503 U.S. at 527; *Ruckelshaus v. Monsanto Co.*, 467 U.S. 986, 1003 (1984); *Phillips*, 524 U.S. at 166 n.5.

A "per se" taking similar to that identified in *Phillips* occurred here because, by the Commissioner's authority, Principal took Petitioner's equity interests and assigned Petitioner's right to insurance benefits to a "closed block." IA Code § 508B. The value to be paid in exchange for these contractual rights was not determined privately, by arms length bargaining, but publically, by the Commissioner as being "fair and equitable." The right of ownership and control of the surplus was thus divested and was given to the public investors by the Commissioner's order. In sum, the conversion eliminated Petitioner's "possession, use and control" of property by determination of the Commissioner rather than by contract or private bargaining.

This abrogation of contractual rights involved state compulsion or "required acquiescence" which "is at the heart of the concept of occupation." *Yee*, 503 U.S. at 527 (quoting *FCC v. Florida Power Corp.*, 480 U.S. 245, 252 (1987)). The absence of consent is a key element of a "taking" as this Court explained, "The line which separates these cases from *Loretto* is the unambiguous distinction between a commercial lease and an interloper with a government license." *Florida Power*, 480 U.S. at 252-53. Here, Principal was acting with a state license rather than with contractual consent. A "statutory conversion" is accomplished without the members' established contractual consent. Principal did not use the contracted-for method of modification, but instead used the state's authority under the Conversion Law. Nor did the vote of members provide the consent for the loss of individual contractual rights. A vote of some or a majority cannot destroy rights given by contracts of the corporation. RUSS & SEGALLA, 3 COUCH ON INS. § 39:24 (3d ed. 1995-1996). In a mutual company, a vote of the membership cannot take away individual contractual interests because the members are both owners and customers of the company. *Parish v. New York Produce Exch.*, 169 N.Y. 34, 49, 61 N.E. 977, 981 (1901).

Finally, a Takings claim arises by the failure to provide full or equivalent compensation. "When the government physically takes possession of an interest in property for some public purpose, it has a categorical duty to compensate the former owner." *Brown v. Legal Foundation of Washington*, 123 S.Ct. 1406, 1418 (2003). "'[J]ust compensation' means the full monetary equivalent of the property taken. The owner is to be put in the same position monetarily as he would have occupied if his property

had not been taken." *Id.* at 1419. *See also United States v. Virginia Elec. & Power Co.*, 365 U.S. 624 (1961).[6] A statutory conversion, as alleged here, deprives full and equivalent compensation. Clinton, *The Rights Of Policyholders In An Insurance Demutualization*, 41 Drake L. Rev. 657, 689 (1992) ("These provisions prevent policyholders from receiving the market value of their ownership interest").

III. The Constitutional Questions Presented Affect The Valuable Property Rights Of Millions Of Mutual Policyholders Whose Contractual Rights May Be Taken By A Statutory Conversion

The widespread use of statutory conversions affect significant and valuable property rights. A mutual life insurance contract evidences property because it is a formal understanding supporting a claim of entitlement. *Bishop v. Wood*, 426 U.S. 341 (1976); *United States Trust Co. of New York v. New Jersey*, 431 U.S. 1, 19 n.16 (1977) ("Contract rights are a form of property and as such may be taken for a public purpose") and *United States v. General Motors Corp.*, 323 U.S. 373, 378 (1945). The contracts here conferred proportionate ownership of a common fund (the mutual surplus) and its earnings, which

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[6] The Takings Clause mandates that a statutory procedure to adjudicate just compensation be provided where a taking is itself authorized. In the absence of a statutory procedure, a direct action exists under the Takings Clause. *First English Evangelical Church of Glendale v. County of Los Angeles, California*, 482 U.S. 304, 314-15 (1987) (citing *Jacobs v. United States*, 290 U.S. 13, 27 (1933)) (The Takings Clause "secures *compensation* in the otherwise proper interference amounting to a taking.").

evidences property. *Phillips v. Washington Legal Foundation*, 524 U.S. at 166 n.5 (1998) ("The earnings of a fund are incidents of ownership of the fund itself and are property just as the fund itself is property").

The Treasury Department specifically recognizes policyholders' contractual and ownership rights in its tax treatment of mutual insurers. Department Of The Treasury, *Report To The Congress On Property And Casualty Insurance Company Taxation* (Apr. 1991) and Department Of Treasury, *Final Report To The Congress On Life Insurance Company Taxation* at 23 (Aug. 1989) ("A 'participating' policy is one through which a policyholder buys not only some amount of term insurance and the equivalent of a savings certificate, but also an equity-like interest in the insurance company."). Lower federal courts have characterized the mutual life insurance contract to include, *inter alia*, the common equitable ownership of the assets by the members which may at their option be transferred into legal title and reduced to possession by dissolution of the company and the right to choose management. *Mutual Fire Ins. Co. of Germantown v. United States*, 142 F.2d 344, 348 (3d Cir. 1944); *Mutual Benefit Life Ins. Co. v. Herold*, 198 F. 199, 206-212 (D.N.J. 1912), *aff'd*, 201 F. 918 (3d Cir. 1913); *Keystone Auto. Club Cas. Co. v. Commissioner of I.R.S.*, 122 F.2d 886, 890 (3d Cir. 1941); *Rev. Ruling* 74-196, 26 C.F.R. 1.501(c)(15)-1 ["Mutual Insurance Company; definition"].[7]

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[7] *See also Lawrence v. Nelson*, 21 N.Y. 158, 160-161 (1860); *Commonwealth v. Massachusetts Mut. Fire Ins. Co.*, 112 Mass. 116 (1873); *McPherson v. Railway Sav. & Bldg. Ass'n*, 93 Colo. 155, 159-60, 25 P.2d 388, 389 (1933); *Carlton v. Southern Mut. Ins. Co.*, 72 Ga. 371

(Continued on following page)

The constitutional question presented is compelling given that a "statutory conversion" operates as a statutory method for the forced redemption of one's property to be given to another private party. As recognized by the First Circuit in *UNUM Corp. v. United States*, 130 F.3d 501, 511 (1997), a conversion constitutes a redemption of ownership rights:

> Here, Union Mutual purchased its policyholders' equity interests and transferred them to UNUM. UNUM in turn exchanged the policyholders' membership interests in Union Mutual for stock in UNUM or cash. UNUM was financially in no worse a position after "paying out" $522 million worth of stock to implement the demutualization than it was before the transaction occurred. What changed was the form of ownership, precisely the topic which capital transactions typically involve.

The widespread effect of statutory conversions on mutual policyholders' property rights presents yet another substantial reason for granting certiorari.

(1884); MAY ON INSURANCE, ch. XXXI, § 548 *"Of Mutual Insurance"* (1900); *Spruance v. Farmers' & Merchants' Ins. Co.*, 9 Colo. 73, 77, 10 P. 285 (Colo. 1886) (citing *Union Ins. Co. v. Hoge*, 62 U.S. 35 (1858)); *Mygatt v. New York Prot. Ins. Co.*, 21 N.Y. 52 (1860); *Ohio Mutual Ins. Co. v. Marietta Woolen Factory*, 3 Ohio St. 348, 351 (1854); *Krugh v. Lycoming Fire Ins.*, 77 Pa. 15 (1874) and R. KEETON, INSURANCE LAW at 33 (3d ed. 1988).

CONCLUSION

Wherefore, it is respectfully requested that this Honorable Court accept certiorari here and in the related case of *Tancredi v. Metropolitan Life Ins. Co.*, 316 F.3d 308 (2nd Cir. 2003), in which a Petition for Writ of Certiorari is also being filed to address these important questions.

Respectfully submitted,

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Dated: April 21, 2003

APPENDIX A

311 F.3d 851

United States Court of Appeals,
Seventh Circuit.

Esther L. GAYMAN, Plaintiff-Appellant,
v.
PRINCIPAL FINANCIAL SERVICES, INC.,
Principal Financial Group, Inc., and
Principal Life Insurance Company,
Defendants-Appellees.

No. 02-2298.

Argued Nov. 7, 2002.
Decided Nov. 22, 2002.
Rehearing and Rehearing En Banc Denied Dec. 17, 2002.

James M. Pietz (argued), Richard A. Finberg, Malakoff, Doyle & Finberg, Pittsburgh, PA, for Plaintiff-Appellant.

Daniel J. McMahon, Wilson, Elser, Moskowitz, Edelman & Dicker, Chicago, IL, Lorin L. Reisner (argued), Debevoise & Plimpton, New York, NY, for Defendants-Appellees.

Before BAUER, EASTERBROOK, and MANION, Circuit Judges.

EASTERBROOK, Circuit Judge.

Principal Life Insurance Co. converted from mutual to stock form in 2001. Although the insurer itself had converted in 1998, it became a wholly owned subsidiary of Principal Mutual Holding Co., which remained a mutual. This left the policyholders with voting control and the right to receive any surplus should the insurer liquidate,

but it saddled the firm with a major drawback – inability to raise capital via the stock market. In the 2001 reorganization all vestiges of the mutual form vanished. Conversion was authorized unanimously by the holding company's board of directors (elected by the policyholders) and ratified by 92% of those policyholders who participated in the vote. Iowa, under whose law the firms are organized, permits demutualization if the policyholders and the Commissioner of Insurance approve. See Iowa Code §§ 508B2, 521A.14(5)(b). Administrative approval was given on August 28, 2001, and the conversion occurred on October 26, 2001.

Dissenting policyholders could have sought judicial review of the Commissioner's decision under Iowa law but did not. They might have asked the state courts to review the transaction for compliance with state law but did not. Instead policyholder Esther Gayman filed this suit in federal court, purportedly under 42 U.S.C. § 1983, against the insurer and its new parent corporations. (The suit also named as defendants the old holding company and other firms that vanished in the transaction. Their rights and liabilities have been assumed by the surviving firms. We have reformed the caption to list only the extant entities.) According to the complaint, defendants violated the federal Constitution in numerous ways, all of which are variations on the theme that they took the policyholders' "property" (the right to receive any liquidating distribution) without just compensation. But a claim under § 1983 is tenable only if the defendants acted under color of state law – in other words, if they are state actors. See *Rendell-Baker v. Kohn,* 457 U.S. 830, 838, 102 S.Ct. 2764, 73 L.Ed.2d 418 (1982). The district judge concluded that they are not and dismissed the suit under Fed.R.Civ.P. 12(b)(1),

for it cannot be recast as a state-law claim under the diversity jurisdiction (Gayman does not contend that her extinguished rights were worth more than $75,000).

According to Gayman, the insurer and its holding-company structure are state actors for two reasons: first, they took advantage of provisions in state law that authorized the conversion (and, she says, valued her interest below its true worth); second, they sought and obtained permission from the Commissioner of Insurance. Neither of these elements, however, demonstrates state action. The impetus and the actors remain private. That "a business is subject to state regulation does not by itself convert its action into that of the State for purposes of the Fourteenth Amendment." *Jackson v. Metropolitan Edison Co.,* 419 U.S. 345, 350, 95 S.Ct. 449, 42 L.Ed.2d 477 (1974). See also, e.g., *Blum v. Yaretsky,* 457 U.S. 991, 102 S.Ct. 2777, 73 L.Ed.2d 534 (1982); *Flagg Bros., Inc. v. Brooks,* 436 U.S. 149, 98 S.Ct. 1729, 56 L.Ed.2d 185 (1978). Nor does the need to obtain official approval turn private action into public action. See, e.g., *American Manufacturers Mutual Insurance Co. v. Sullivan,* 526 U.S. 40, 119 S.Ct. 977, 143 L.Ed.2d 130 (1999). Putting state regulation together with official approval does not affect the outcome: 0 + 0 = 0.

If things were otherwise, most if not all private acts would be attributed to the state and subject to constitutional limitations – even though these limitations are designed to protect people from government rather than from each other. See *DeShaney v. Winnebago County Department of Social Services,* 489 U.S. 189, 109 S.Ct. 998, 103 L.Ed.2d 249 (1989); *Archie v. Racine,* 847 F.2d 1211 (1988) (en banc). All corporate management is subject to control under state law (including judicial review of managers' competence and loyalty); some decisions require

advance approval; yet it would be preposterous to say that all corporate acts therefore are state acts. One might as well contend that all lawyers' deeds are state action because lawyers have licenses and are subject to regulation on ethics and other subjects, or that all landlords are state actors because buildings must conform to zoning and safety codes.

A *real* state actor was involved in the demutualization: Iowa's Commissioner of Insurance. But she has not been sued, perhaps because any claim that the Commissioner took Gayman's property would be frivolous. See *Ordower v. Office of Thrift Supervision,* 999 F.2d 1183, 1187 (7th Cir.1993). The transaction was initiated and ratified by the policyholders. Iowa did not compel any mutual to convert; it just made reorganization possible, as state corporate law facilitates mergers. Until early in the Twentieth Century mergers required unanimous consent, and in many states corporate charters were special legislative grants. Today anyone can incorporate and mergers may be approved by majority vote. Those legal changes, which facilitate private ordering, did not turn corporations into state actors. Instead they enlarged the scope of private law. Just so for mutual-to-corporate conversions. If the opportunity to buy securities at a discount (the normal replacement for policyholders' residual claims, see *Ordower* and, e.g., *SEC v. Jakubowski,* 150 F.3d 675 (7th Cir.1998)) was inadequate here, the proper remedy was a suit in state court under state law seeking an order blocking the conversion or altering its terms.

AFFIRMED

APPENDIX B

No. 01 C 50346.

United States District Court, N.D. Illinois.

April 18, 2002.

MEMORANDUM OPINION AND ORDER

REINHARD.

Plaintiff, Esther L. Gayman, has filed a five-count complaint against various defendants, all of which are in some way affiliated with Principal Life Insurance Co., an Iowa corporation (all defendants will be referred to collectively as "Principal"). Bringing all of her claims under 42 U.S.C. § 1983, Gayman alleges Principal's conversion from a mutual insurance holding company to a stock company, or "demutualization," constitutes a taking of private property without just compensation in violation of the Fifth and Fourteenth Amendments (Counts I and II), and violates both the Commerce Clause (Count III) and the Contracts Clause (Counts IV and V). Before the court is Principal's motion to dismiss for failure to state a claim, filed pursuant to Federal Rule of Civil Procedure 12(b)(6).[1]

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[1] Although both sides have introduced numerous exhibits either in support of or in response to the motion to dismiss, the court has not converted the motion into one for summary judgment. *See* Fed.R.Civ.P. 12(b). This is primarily because many of the exhibits are not relevant to the court's analysis in this order. To the extent some of them are, the court may consider them because they are either attached to the complaint or incorporated by reference in the complaint and central to Gayman's allegations. *See* Fed.R.Civ.P. 10(c); *Wright v. Associated Ins. Cos. Inc.*, 29 F.3d 1244, 1248 (7th Cir.1994). The parties themselves agree this is so and also have informed the court by letter that they agree there are no issues of fact that would affect the court's ruling on

(Continued on following page)

Although Principal has raised a number of reasons why it believes Gayman's complaint must be dismissed, the court focuses only on the first of these as it underpins the entire case. Because all of her claims are based on § 1983, Gayman must show Principal acted "under color of state law," which means its conduct must satisfy the "state action" requirement of the Fourteenth Amendment. *See American Mfrs. Mut. Ins. Co. v. Sullivan,* 526 U.S. 40, 50 n. 8 (1999). Thus, the question before the court is whether Principal's decision to demutualize may be "fairly attributable" to the state of Iowa. *Id.* at 51. To show that it is, Gayman points out that Iowa law required Principal, which is concededly a purely private corporation, to have its conversion plan reviewed and approved by Iowa's Commissioner of Insurance ("Commissioner"). *See* Iowa Code § 508B.7. Under Iowa's conversion law, the Commissioner may conduct hearings if appropriate and, as she did in Principal's case, retain consultants in preparing a lengthy and detailed report where she made her findings of fact and conclusions of law, explaining why in her opinion Principal's plan met the statutory requirements for conversion. (Def.Exh. C) In the court's opinion, however, none of this transforms Principal's decision to convert into state action and Gayman's arguments to the contrary stretch the state action doctrine too far.

As the Supreme Court has said before, "[a]ction taken by private entities with the mere approval or acquiescence of the State is not state action." *Sullivan,* 526 U.S. at 52

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the purely legal issues raised by Principal's motion, so giving them an opportunity to supplement the record with additional materials is simply not necessary in this case.

(citations omitted). What matters here is that neither the Commissioner nor the state of Iowa were involved in the "purely private choice" made by Principal to demutualize. *See Flagg Bros., Inc. v. Brooks,* 436 U .S. 149, 165 (1978). Because the decision and initiative to convert came entirely from Principal and not from the Commissioner, Principal's exercise of a statutory right allowed by Iowa law "does not make its action in doing so 'state action.'" *Jackson v. Metropolitan Edison Co.,* 419 U.S. 345, 357 (1974). Gayman herself all but acknowledges this in her response brief when she says that the "specific conduct that is alleged here is *not that the State forced Principal to demutualize.* . . . " (Pl.Resp., p. 13) (emphasis in original) But that is exactly the point. It is precisely because the Commissioner did *not* order the demutualization that there is no state action. *See id.* ("Approval by a state utility commission of . . . a request from a regulated utility, *where the commission has not put its own weight on the side of the proposed practice by ordering it,* does not transmute a practice initiated by the utility and approved by the commission into 'state action.'") (emphasis added). The bottom line is that the Commissioner was "in no way responsible" for Principal's original decision to demutualize, *Flagg Bros.,* 436 U .S. at 165, and her mere approval of that decision is simply not enough to trigger state action.

A majority of lower courts have come to the same conclusion in the "demutualization" context, holding that a private insurance company's decision to convert from mutual to stock form did not involve state action, even when the conversion required state approval. *See Tancredi v. Metropolitan Life Ins. Co.,* 149 F.Supp.2d 80, 84-86 (S.D.N.Y.2001); *Cranley v. National Life Ins. Co. of Vt.,* 144

F.Supp.2d 291, 303-04 (D.Vt.2001); *Crandall v. Alderfer,* No. 97-CV-957, 1999 WL 116293, at *3 (E.D.Pa. Mar. 5, 1999). *But see Lovell v. Peoples Heritage Sav. Bank,* 776 F.Supp. 578, 581-88 (D.Me.1991). In fact, the plaintiff's allegations in *Tancredi* are virtually identical to Gayman's allegations here, perhaps explained by the fact that plaintiffs' counsel in *Tancredi* also represents Gayman. *See Tancredi,* 149 F.Supp.2d at 83. Though not exactly on point, the Seventh Circuit has also held in an analogous context that a plaintiff could not sustain a constitutional due process claim against a privately-owned savings and loan association for converting from mutual to stock form for lack of state action, despite the fact that the conversion required the S & L to obtain the approval of, and follow the procedures of, the federal Office of Thrift Supervision. *See Ordower v. Office of Thrift Supervision,* 999 F.2d 1183, 1187 (7th Cir.1993). Given this authority, the court finds Gayman's suit fails the state action requirement and her entire complaint must therefore be dismissed.

For the reasons stated above, Principal's motion to dismiss is granted and this case is hereby dismissed in its entirety.

APPENDIX C

United States Court of Appeals
For the Seventh Circuit
Chicago, Illinois 60604

December 17, 2002

Before

Hon. WILLIAM J. BAUER, Circuit Judge

Hon. FRANK H. EASTERBROOK, Circuit Judge

Hon. DANIEL A. MANION, Circuit Judge

ESTHER L. GAYMAN, *Plaintiff-Appellant,* **No.** 02-2298 v. PRINCIPAL FINANCIAL SERVICES, INC., PRINCIPAL FINANCIAL GROUP, INC., and PRINCIPAL LIFE INSURANCE COMPANY, *Defendants-Appellees.*	)	Appeal from the United States District Court for the Northern District of Illinois, Western Division. No. 01 C 50346 Philip G. Reinhard, *Judge.*

Order

Plaintiff-appellant filed a petition for rehearing and rehearing en banc on December 6, 2002. No judge in regular active service has requested a vote on the petition for rehearing en banc, and all of the judges on the panel have voted to deny rehearing. The petition for rehearing is therefore DENIED.

APPENDIX D

Iowa Code 2001: Chapter 508B

CHAPTER 508B CONVERSION FROM MUTUAL COMPANY TO STOCK COMPANY

Applies to plans of conversion established after July 1, 1985; 85 Acts, ch 127, § 16

Referred to in § 87.4, 296.7, 331.301, 331.440A, 364.4, 521A.14, 669.14, 670.7

508B.1 Definitions.
508B.2 Mutual company becoming stock company – authorization.
508B.3 Conversion plans to be fair and equitable – alternative procedures and requirements.
508B.4 Eligible policyholders participation.
508B.5 Appointment of consultant.
508B.6 Approval of plan by policyholders – notice of election – effective date.
508B.7 Review of plan by commissioner – hearing authorized – approval.
508B.8 Payment of fees, salaries and costs.
508B.9 Act of conversion – continuation of company.
508B.10 Continuation of officers.
508B.11 Rules.
508B.12 Amendments – withdrawal.
508B.13 Prohibitions on certain offers to acquire shares.
508B.14 Limitation of actions – security for attorney fees.
508B.15 Duties of secretary of state.

508B.1 Definitions.

As used in this chapter, unless the context clearly indicates otherwise:

1. *"Commissioner"* means the commissioner of insurance.

2. *"Mutual life insurance company"* or *"mutual company"* means a level premium and natural premium life insurance company authorized under chapter 508 upon the mutual plan and includes a domestic company which meets the requirements of section 508.12.

3. *a. "Plan of conversion"* or *"conversion plan"* means a plan authorized by section 508B.3 and, in the case of plans authorized by section 508B.3, subsections 1 and 3, includes a procedure by which the mutual company's participating policies and contracts in force on the effective date of the conversion plan are operated by the reorganized company as a closed block of participating business for the exclusive benefit of the policies and contracts included, for dividend purposes only; to which are allocated assets of the mutual company in an amount which together with anticipated revenue from the business is reasonably expected to be sufficient to support the business; and which includes, but is not limited to, provisions for payment of claims and reasonable expenses, and provisions for continuation of current payable dividend scales if the experience underlying the scales continues, and a procedure for appropriate adjustments in the scales if the experience changes. However, at the option of the mutual company, some or all classes of group policies and contracts shall not be placed in the closed block but shall continue to be eligible to receive dividends based on the experience of the class or classes.

b. If any amount of the policyholders' consideration as specified in section 508B.3, subsection 3, paragraph *"b"*, for certain classes of policies or contracts is to be paid in

the form of increased annual dividends to the policyholders in those classes, that amount is to be added to the assets allocated as provided in paragraph "*a*" and is to be paid to those classes.

4. "*Policyholder*" means a person, determined by the mutual company, who is the holder of a policy or annuity contract for the purposes of section 508B.3, subsection 1, 2, or 3.

5. "*Policyholders' membership interest*" means all policyholders' rights as members of the mutual company including, but not limited to, rights to vote and participate in any distribution of surplus whether or not incident to liquidation of the mutual company.

6. "*Reorganized company*" means the domestic stock company into which a mutual company has been converted, converted and merged, or converted and consolidated.

7. "*Stock life insurance company*" or "*stock company*" means a life insurance company authorized under chapter 508 upon the stock plan and includes a domestic company which meets the requirements of section 508.12.

508B.2 Mutual company becoming stock company – authorization.

A mutual life insurance company may become a stock life insurance company pursuant to a plan of conversion established and approved in the manner provided by this chapter.

A plan of conversion may provide that a mutual company may convert into a domestic stock company, convert and merge, or convert and consolidate with a domestic stock company, as provided in chapter 490 or 491, whichever is applicable. However, the mutual company is not required to comply with sections 491.102 through 491.105 or sections 490.1101 and 490.1103 relating to approval of merger or consolidation plans by boards of directors and shareholders, if at the time of approval of the plan of conversion the board of directors approves the merger or consolidation and if at the time of approval of the plan by policyholders as provided in section 508B.6, the policyholders approve the merger or consolidation. This chapter supersedes any conflicting provisions of chapters 521 and 521A. A mutual company may convert, merge, or consolidate as part of a plan of conversion in which a majority or all of the common shares of the stock company are acquired by another corporation, which may be a corporation organized for that purpose, or in which the new stock company consolidates with a stock company to form another stock company.

In lieu of selecting a plan of conversion provided for in this chapter, a mutual company may convert to a stock company pursuant to a plan approved by the commissioner. The commissioner or the mutual company may use any provisions or combination of provisions provided for a plan in this chapter and may adopt any other provisions which are not unfair or inequitable to the policyholders of the mutual company. If a mutual company selects this procedure for conversion purposes, the mutual company shall reimburse the state for expenses incurred by the division in connection with the conversion plan except for expenses that are normal operating expenses of the division.

508B.3 Conversion plans to be fair and equitable – alternative procedures and requirements.

A plan of conversion shall be fair and equitable to policyholders. A plan of conversion is fair and equitable if it satisfies the conditions of subsection 1, 2, or 3. The commissioner may determine whether any other plan proposed by a mutual company is fair and equitable to its policyholders.

1. Subject to paragraph "*b*", a plan of conversion under this subsection shall provide all of the following:

a. The policyholders' membership interest shall be exchanged, in a manner which takes into account the estimated proportionate contribution of surplus of each class of participating policies and contracts, for all of the common shares of the reorganized company or its parent company, if any, or for either or a combination of the common shares of the reorganized company or its parent company, if any, and consideration equal to the proceeds of the sale of the common shares by the issuer or by a trust or other entity existing for the exclusive benefit of policyholders and established solely for the purpose of effecting the conversion, to which trust or other entity the common shares, or the options to acquire or securities convertible into the common shares, shall be issued by the issuer on the effective date of the conversion. The consideration shall be distributed to policyholders during a process of conversion specified in the plan which shall not last more than ten years after the effective date of conversion or until the death of the policyholder, whichever occurs first.

b. Unless the anticipated issuance within a shorter period is disclosed, the issuer of common shares shall not,

within two years after the effective date of reorganization, issue either of the following:

(1) Any of its common shares or any securities convertible with or without consideration into the common shares or carrying any warrant to subscribe to or purchase common shares.

(2) Any warrant, right or option to subscribe to or purchase the common shares or other securities described in subparagraph (1), except for the issue of common shares to or for the benefit of policyholders pursuant to the plan of conversion and the issue of stock in anticipation of options for the purchase of common shares being granted to officers or employees of the reorganized company or its parent company, if any, pursuant to this chapter.

c. Unless the common shares have a public market when issued, the issuer shall use its best efforts to encourage and assist in the establishment of a public market for the common shares within two years of the effective date of the conversion or a longer period as disclosed in the plan of conversion. Within one year after the offering of stock other than the initial distribution, but no later than six years after the effective date of the conversion, the reorganized company shall offer to make available to policyholders who received and retained shares of stock with minimal values on conversion, a procedure to dispose of those shares of stock at market value without brokerage commissions or similar fees.

2. A plan of conversion under this subsection shall provide all of the following:

a. The mutual company's participating business, comprised of its participating policies and contracts in

force on the effective date of the conversion, shall be operated by the reorganized insurer as a closed block of participating business. However, at the option of the mutual company, group policies and group contracts may be omitted from the closed block.

b. Assets of the mutual company shall be allocated to the closed block of participating business in an amount equal to the reserves and liabilities for the mutual life insurer's participating policies and contracts in force on the effective date of the conversion.

c. The consideration to be given in exchange for the policyholders' membership interest consists of aggregate consideration in a form or forms selected by the mutual company having a value equal to the amount of the statutory surplus of the mutual life insurer.

d. The consideration is allocated among the policyholders in a manner which is fair and equitable to the policyholders.

e. The reorganized company or its parent corporation shall issue and sell shares of one or more classes having a total price equal to the estimated value in the market on the initial offering date of the shares.

f. The estimated value shall take into account all of the following:

(1) The consideration to be given to policyholders pursuant to paragraph "*c*".

(2) The proceeds of the sale of the shares.

(3) Any additional value attributable to the shares as a result of a purchaser or a group of purchasers who acted in

concert to obtain shares in the initial offering, attaining, through such purchase, control of the reorganized company or its parent corporation.

g. If a purchaser or a group of purchasers acting in concert is to attain such control in the initial offering, the mutual company shall not, directly or indirectly, pay for any of the costs or expenses of conversion of the mutual company, whether or not the conversion is effected.

h. The reorganized company may share in the profits of the closed block of participating business for the benefit of stockholders.

3. A plan of conversion under this subsection shall satisfy all of paragraphs "*a*" through "*j*" and may add or substitute, as applicable, the options provided in paragraphs "*k*" and "*l*".

a. The reorganized company or its parent corporation shall issue and sell shares of one or more classes having a total price equal to the estimated market value on the initial offering taking into account the value to be given to participating policyholders pursuant to paragraph "*b*" and the proceeds of the sale.

b. The participating policyholders' consideration shall be based on the latest annual statement, updated to the effective date of the conversion plan, and filed prior to the effective date of the adoption by the board of directors of the plan of conversion. The policyholders' consideration shall be equal to the sum of the total amount of assets allocated to the participating business and an amount equal to reserves and other liabilities attributable to any group participating policies and contracts not included in the closed block of participating business.

c. The consideration to be given in exchange for the policyholders' membership interest shall consist of the participating policyholders' consideration and nontransferable preemptive subscription rights to purchase all of the common shares of the issuer and the establishment of a liquidation account for the benefit of the policyholders in the event of a subsequent complete liquidation of the reorganized company having the terms described in paragraph "*j*".

d. The consideration and the preemptive subscription rights to purchase the common shares shall be allocated among the participating policyholders in a manner determined by the reorganized company which takes into account the estimated contribution of each class of participating policies and contracts to the total amount of the policyholders' consideration.

e. The number of the common shares which any person, together with any affiliates or group of persons acting in concert, may subscribe for or purchase in the reorganization shall be limited to not more than five percent of the common shares. For this purpose, neither the members of the board of directors of the reorganized company nor of its parent corporation, if any, shall be deemed to be affiliates or a group of persons acting in concert solely by reason of their board membership.

f. Unless the common shares have a public market when issued, officers and directors of the issuer and their affiliates shall not, for at least ninety days after the date of conversion, purchase common shares of the issuer, except in negotiated transactions involving more than ten percent of the outstanding common shares.

g. Unless the common shares have a public market when issued, the issuer shall use its best efforts to encourage and assist in the establishment of a public market for the common shares.

h. The issuer shall not, for at least three years following the conversion, repurchase any of its common shares except pursuant to a pro rata tender offer to all shareholders.

i. Until the liquidation account has been reduced to zero, the issuer shall not declare or pay a cash dividend on, or repurchase any of, its common shares in an amount in excess of its cumulative earned surplus generated after the conversion determined in accordance with generally accepted accounting principles, if the effect would be to cause the amount of the statutory surplus of the reorganized company to be reduced below the then amount of the liquidation account.

j. The liquidation account referred to in paragraph "*c*" must be equal to the excess of the total amount of the assets of the mutual company as of the effective date of the conversion over the sum of the total amount of assets allocated to the closed block of participating business and the policyholders' consideration and other reserves and liabilities attributed to policies and contracts not included in the amount attributable to policies and contracts in force on that effective date. The determinations shall be based on the latest annual statement of the mutual company, updated to the effective date, and filed before the effective date of the conversion plan. The function of the liquidation account is solely to establish a priority on liquidation and its existence does not restrict the use or application of the surplus of the reorganized company

except as specified in paragraph "*i*". The liquidation account shall be allocated equally as of the effective date of conversion among the then participating policyholders. The amount allocated to a policy or contract shall not increase and shall be reduced to zero when the policy or contract terminates. In the event of a complete liquidation of the reorganized company, the policyholders among which the liquidation account is allocated are entitled to receive a liquidation distribution in the then amount of the liquidation account before any liquidation distribution is made with respect to shares.

k. At the option of the mutual company, the consideration to be given in exchange for the policyholders' membership interests may consist of cash, securities of the reorganized company, securities of another institution, a certificate of contribution, additional life insurance, annuity benefits, increased dividends, or other consideration or any combination of forms of consideration. The consideration, if any, given to a class or category of policyholders may differ from the consideration given to another class or category of policyholders. The certificate of contribution shall be repayable in ten years, equal to one hundred percent of the value of the policyholders' membership interest, and bear interest at the highest rate charged by the reorganized company for policy loans on the effective date of the conversion.

l. At the option of the mutual company, a plan may provide that any shares of the stock of the reorganized company or its parent corporation included in the policyholders' consideration shall be placed on the effective date of the conversion in a trust or other entity existing for the exclusive benefit of the participating policyholders and

established solely for the purpose of effecting the reorganization. Under this option, the shares placed in trust shall be sold over a period of not more than ten years and the proceeds of the shares shall be distributed using the distribution priorities prescribed in the plan.

508B.4 Eligible policyholders participation.

The policyholders who are entitled to notice of and to vote upon approval of a plan of conversion and entitled to notice of a public hearing are the policyholders whose policies or contracts are in force on the date of adoption of the plan of conversion. Each policyholder whose policy has been in force for at least one year prior to the date is entitled to the consideration, if any, provided for the policyholder in the plan based on the policyholder's membership interest determined pursuant to this chapter, but only if the policyholder's membership interest arose from a policy or contract in force on the effective date of the conversion and such membership interest has been held continuously for at least one year prior to the date of adoption of the plan. For this purpose, any changes in status of, or premiums in excess of, those required on the policies or contracts occurring or made after the date one year prior to the date of adoption of the plan shall be disregarded.

508B.5 Appointment of consultant.

A plan may provide for the appointment by the mutual company of a person as defined in section 4.1, subsection

20, who is qualified to act as a consultant. The appointment of the consultant shall be reviewed by the commissioner and unless the commissioner finds the consultant unqualified, the consultant shall carry out the duties required by the mutual company and this chapter.

The consultant may assist in determining the equity of the policyholders or value of the mutual company. The consultant may consider the value of the consideration to be given to the participating policyholders in exchange for their membership interests and may consider the valuations necessary to carry out the plans provided for in section 508B.3. Valuations shall be made taking into account the latest filed annual statement of the mutual company, updated to the effective date of the conversion plan, and any significant developments occurring subsequent to the date of the statement.

The findings of the consultant may be modified by the mutual company at any time so long as the results are not unfair or inequitable to policyholders.

If it can be shown by the mutual company to the commissioner that an underwriter of the shares is a qualified person, the underwriter may be appointed as the consultant.

508B.6 Approval of plan by policyholders – notice of election – effective date.

The plan of conversion shall be submitted to and shall not take effect until approved by two-thirds of the policyholders of the mutual company voting on the plan. Notice of a meeting for the purpose of voting on the conversion plan

shall be provided by mail to each policyholder entitled to vote in accordance with the articles of incorporation or bylaws of the mutual company. Each policyholder entitled to vote may cast one vote unless otherwise provided in the articles of incorporation or bylaws of the mutual company. Voting shall be by ballot, in person or by proxy. A quorum shall consist of a quorum as defined in the articles of incorporation or bylaws of the mutual company. A copy of the plan of conversion, or a summary of the plan of conversion, shall accompany the notice of meeting and election. The notice of meeting may contain the notice of any planned public hearing. An approved plan of conversion shall take effect on the date specified in the plan.

508B.7 Review of plan by commissioner – hearing authorized – approval.

The commissioner of insurance shall review the plan. The commissioner shall approve the plan if the commissioner finds the plan complies with all provisions of law, the plan is fair and equitable to the mutual company and its policyholders, and that the reorganized company will have the amount of capital and surplus deemed by the commissioner to be reasonably necessary for its future solvency. The commissioner may order a hearing on the fairness and equity of the terms of the plan after giving written notice of the hearing to the mutual company, its policyholders, and other interested persons, all of whom have the right to appear at the hearing. Costs incurred in connection with the notice shall be paid by the company.

508B.8 Payment of fees, salaries and costs.

A director, officer, agent or employee of the mutual company shall not receive a fee, commission or other valuable consideration, other than regular salary and compensation, for aiding, promoting or assisting in the conversion except as set forth in the plan approved by the commissioner. This section does not prohibit the payment of reasonable fees and compensation to a consultant, attorneys at law, accountants, actuaries or other persons specifically employed for services performed in the practice of their professions while completing the plan of conversion, even if these persons are directors of the mutual company.

508B.9 Act of conversion – continuation of company.

When the commissioner and the policyholders approve the conversion plan as provided in this chapter, the commissioner shall issue a new certificate of authority to the reorganized company effective on the effective date of the conversion as provided in the plan. The reorganized company is a continuation of the mutual life insurance company and the conversion shall not annul or modify any of the mutual company's existing suits, contracts, or liabilities except as provided in the approved conversion plan. All rights, franchises, and interests of the mutual company in and to property, assets, and other interests shall be transferred to and shall vest in the reorganized company and the reorganized company shall assume all obligations and liabilities of the mutual company.

The reorganized company shall exercise all rights and powers and perform all duties conferred or imposed by law

on life insurance companies writing the classes of insurance written by it, and shall retain the rights and contracts existing before conversion, subject to provisions of the plan.

508B.10 Continuation of officers.

The directors and officers of the mutual company shall serve the reorganized company until new directors and officers are elected and qualify pursuant to the articles of incorporation and bylaws of the reorganized company.

508B.11 Rules.

The commissioner shall issue rules pursuant to chapter 17A to carry out the provisions of this chapter.

508B.12 Amendments – withdrawal.

At any time before the conversion, if done pursuant to rules issued by the commissioner or as may otherwise be required by the commissioner, the board of directors of a mutual company may amend the conversion plan. An amendment to a conversion plan is subject to the prior approval of the commissioner. The board of directors of a mutual company may withdraw the plan of conversion at any time prior to the conversion.

508B.13 Prohibitions on certain offers to acquire shares.

Prior to and for a period of five years following the effective date of the conversion, and in the case of the plans of conversion specified in subsections 1 and 3 of section 508B.3, five years following the date of distribution of consideration to the policyholders in exchange for their membership interests, a person, other than the reorganized company, other than an employee benefit plan or employee benefit trust sponsored by the reorganized company, or as otherwise specifically provided for in the plan of conversion, shall not directly or indirectly acquire or offer to acquire the beneficial ownership of more than five percent of any class of voting security of the reorganized company, and a person, other than the reorganized company or other than an employee benefit plan or employee benefit trust sponsored by the reorganized company, who acquires five percent or more of any class of voting security of the reorganized company prior to the conversion or as specifically provided for in the plan of conversion, shall not directly or indirectly acquire or offer to acquire the beneficial ownership of additional voting securities of the reorganized company, unless the acquisition is approved by the commissioner as not being contrary to the interests of the policyholders of the reorganized company or its life insurance company subsidiary and by the board of directors of the reorganized company. The commissioner and the board of directors may consider the factors set forth in section 490.1108. The provisions of section 521A.3, except subsection 4, paragraph "*a*", shall be applicable to a proposed acquisition subject to this section. An approved plan of conversion may include a stock option plan. As used in this section, "*beneficial ownership*" means, with respect to a security, the sole or

shared power to vote or direct the voting of the security or the sole power to dispose or direct the disposition of the security.

508B.14 Limitation of actions – security for attorney fees.

The commissioner's order approving or disapproving a plan of conversion shall be considered final agency action under chapter 17A.

An action challenging the validity of a conversion plan, or any part of a conversion plan, shall not be commenced more than thirty days following the date of approval by the commissioner, unless an application for rehearing is filed pursuant to section 17A.16, subsection 2. If an application for rehearing is filed, then such action must be filed within thirty days after that application is denied or deemed denied or, if the application is granted, within thirty days after the issuance of the commissioner's final decision on rehearing.

The reorganized company or a defendant may petition the court in such an action to give security for the reasonable attorney fees which may be incurred by any party to the action. The amount of the security may be increased or decreased in the discretion of the court having jurisdiction if a showing is made that the security provided is or may become inadequate or excessive.

508B.15 Duties of secretary of state.

After approval of the conversion plan by the commissioner and the policyholders, the secretary of state shall accept for filing a verified copy of the amended articles of incorporation.

APPENDIX E

Iowa Code § 491.39. Legislative control

The articles of incorporation, bylaws, rules and regulations of corporations hereafter organized under the provisions of either Title XII, subtitles 2 through 5, or Title XIII, subtitle 1 or 2, or whose organization may be adopted or amended thereunder, shall at all times be subject to legislative control, and may be at any time altered, abridged or set aside by law, and every franchise obtained, used, or enjoyed by such corporation may be regulated, withheld, or be subject to conditions imposed upon the enjoyment thereof, whenever the general assembly shall deem necessary for the public good.

APPENDIX F

Iowa Code § 12. Amendment or repeal of laws – exclusive privileges

Subject to the provisions of this article, the general assembly shall have power to amend or repeal all laws for the organization or creation of corporations, or granting of special or exclusive privileges or immunities, by a vote of two thirds of each branch of the general assembly; and no exclusive privileges, except as in this article provided, shall ever be granted.

APPENDIX G

IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHER DISTRICT OF ILLINOIS
WESTERN DIVISION

ESTHER L. GAYMAN, on behalf of herself and all other policy-holders similarly situated, Plaintiffs, v. PRINCIPAL MUTUAL HOLDING COMPANY, an Iowa mutual insurance holding company; PRINCIPAL LIFE INSURANCE COMPANY, an Iowa stock life insurance company; PRINCIPAL FINANCIAL GROUP, INC., PRINCIPAL FINANCIAL SERVICES, INC., and PRINCIPAL IOWA NEWCO, INC., Iowa business corporations; and PRINCIPAL FINANCIAL GROUP, INC., a Delaware corporation, Defendants.	) Civil Action No. 01050346) Judge) A JURY TRIAL IS REQUESTED

CLASS ACTION COMPLAINT

The Representative and Class Plaintiff, Esther L. Gayman, individually and on behalf of all other policy-holders similarly situated, makes this her class action complaint against Defendants, alleging on information and belief, as follows:

1. This class action is brought on behalf of the participating policyholders of Principal Life Insurance Company ("Principal Life") against Principal Life, its holding company Principal Mutual Holding Company (the "Principal Mutual"), and affiliated entities.[1] On August 28, 2001, Iowa's Insurance Commissioner (the "Insurance Commissioner") approved a conversion plan (the "Conversion Plan"), which, through various steps described herein, provides for the demutualization of Principal Mutual from a mutual insurance holding company to a stock company. Plaintiff seeks a declaratory judgment that the Insurance Commissioner's approval of the Conversion Plan constitutes the "taking" or "impairment" of participating policyholders' ownership interests and contract rights without "just compensation," in violation of the "Takings Clause" of the Fifth and Fourteenth Amendments; the Commerce Clause, Article I, Section 8, clause 3; and the "Impairment Clause" of Article I, Section 10 of the Constitution.

JURISDICTION AND VENUE

2. Jurisdiction and venue in this Court are proper under 28 U.S.C. § 1343. Each of Plaintiffs' causes of action are based on 42 U.S.C. § 1983. Venue is proper in this district because plaintiff resides in this district and she and some of the class members have been harmed in this district.

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[1] As used herein, unless the context requires otherwise, "Principal" and "Defendants" will refer to Principal Mutual, Principal Life, and the other named defendants collectively. "Eligible Policyholders," and other capitalized terms not specifically defined herein, shall have the meanings ascribed such terms by Principal in the Conversion Plan.

PARTIES AND OTHERS

3. Representative Plaintiff, Esther L. Gayman, is a Principal Life participating policyholder. She owns Principal adjustable life insurance policy No. 4354220, and is insured under Principal's Medicare Supplement Plan, Account No. 86578-15012. Mrs. Gayman resides at 2315 Kilburn Avenue, Rockford, Illinois 61101.

4. Defendant Principal Life Insurance Company ("Principal Life") is an Iowa domestic stock life company incorporated and chartered under the laws of Iowa with a principal place of business is at 711 High Street, Des Moines, Iowa 50392-0420. Formerly known as Principal Mutual Life Insurance Company, Principal Life became a stock life insurance company on July 1, 1998, as a result of a plan of reorganization (the "1998 Reorganization"). Since that time, Principal Life has been an indirect wholly owned subsidiary of Defendant Principal Mutual.

5. Defendant Principal Mutual Holding Company ("Principal Mutual") is an Iowa mutual insurance holding company with a listed address at 711 High Street, Des Moines, Iowa 50392-0650. Under the 1998 Reorganization, Principal Mutual became the parent company of Principal Financial Group, Inc., an Iowa business corporation.

6. Defendant Principal Financial Group, Inc. ("PFG-IA") is an Iowa business corporation, with a listed address at 711 High Street, Des Moines, Iowa 50392-0650. It is a wholly-owned subsidiary of Principal Mutual. Under the 1998 Reorganization, PFG-IA became the parent company of Principal Financial Services, Inc., an Iowa business corporation.

7. Defendant Principal Financial Services, Inc. is an Iowa business corporation with a listed address at 711 High Street, Des Moines, Iowa 50392-0650. It is a wholly-owned subsidiary of PFG-IA. Under the 1998 Reorganization, it became the parent company of Defendant Principal Life.

8. Defendant Principal Iowa Newco, Inc., is an Iowa business corporation with a listed address at 711 High Street, Des Moines, Iowa 50392-0650. It has been recently formed for purposes of effectuating the Conversion Plan which is the subject of this action. Under the Conversion Plan, Principal Mutual will be converted into a stock company and merged into Principal Iowa Newco, Inc., together with PFG-IA and Principal Financial Services, Inc. The surviving entity into which these entities are merged will be named Principal Financial Services, Inc., which will then be a wholly owned subsidiary of Principal Financial Group, Inc., a Delaware corporation ("PFG-DE"), and the 100% parent of Principal Life.

9. Defendant Principal Financial Group, Inc. ("PFG-DE") is a Delaware business corporation with a principal place of business at 711 High Street, Des Moines, Iowa 50392-0650. It was recently formed for purposes of the Conversion Plan which is the subject of this action. Under the Conversion Plan, PFG-DE will become a publicly traded stock company, and will be the direct or indirect parent of all other "Principal" entities, including Principal Life.

10. If the Conversion Plan is implemented, Principal Mutual, which is currently an Iowa mutual insurance holding company, will no longer exist, but will be replaced by PFG-DE which is a Delaware publicly traded stock

corporation, and all membership interests of participating policyholders will be terminated. The Conversion Plan is the vehicle utilized by the Defendants to acquire the ownership interests and contract rights of participating policyholders for less than just compensation.

I. THE POLICYHOLDERS OWNED AND CONTROLLED PRINCIPAL MUTUAL UNDER THE ARTICLES OF INCORPORATION AND CERTIFICATES OF AUTHORITY

11. Policyholders who are members of a mutual life insurance company own and control the company. The right of ownership by a policyholder vests upon the purchase of a policy of insurance that has membership rights in the mutual company. Such membership rights continue to exist as long as the policy is in force.

12. Generally, insurance companies limit membership rights to persons with participating policies. However, on information and belief, all (or alternatively, most) owners of Principal's policies have certain membership rights, with limited exceptions.[2] These ownership rights include the right, to the exclusion of others except other members, to vote and thereby elect the Board of Directors and to otherwise determine fundamental company policies.

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[2] For certain policies issued prior to April 8, 1980, membership rights and ownership rights may in some instances belong to different persons, e.g., where a policy's ownership rights were transferred.

13. While all or most owners of Principal policyholders have certain membership rights, *participating* policyholders have additional rights. These rights include the rights: (1) to obtain insurance at cost; and (2) to receive through dividends a return of unused premiums in excess of amounts needed to cover losses and expenses as determined by their elected board of directors. As a result, they have a common equitable ownership of the assets of the mutual enterprise.

14. A "participating life insurance contract" provides the policyholder a contractual right to participate in surplus, based upon the experience of other policyholders of the same class. To meet its legal and economic obligations to pay insurance claims when they are filed, a mutual insurer charges premiums such that the expected value of premium payments is in excess of the corresponding value of anticipated benefits and expenses. When assets are more than sufficient, as determined by the mutual's board, portions of policyholders' premiums are returned to the policyholders in the form of dividends. The mutual form of company ownership thus allows participating policyholders to obtain insurance protection at cost.

15. Participating policies substantially differ from "non-participating policies" in that an insurer selling "non-participating policies" determines the price or premium of its policy based upon the insurer's estimate with regard to mortality, interest, expense and other factors. A contingency factor and profit loading are then added to the preliminary price to determine a final price which remains constant. If the insurer's estimates are too low, it will lose money, and, if they are high enough, it will make money. In the latter case, it may be unable to sell policies if competitors can offer a similar product for a better price.

The relationship between the insurer and the policyholder with a non-participating policy is analogous to that of a debtor-creditor.

16. By contrast, the premiums for "participating policies," such as those offered by Principal, are determined using formulae that are structurally similar to those used with "non-participating" policies, except that the primary assumption factors will have a conservative rather than a "best-estimate" expression. This results in up-front policy premiums which are usually higher than those of similar "non-participating" policies. As experience unfolds, the respective portions of up-front premium that, in retrospect, turn out to have been excessive, are returned as dividends. Over the long run, this process results in adjusted contract prices that are equal to the actual cost of such insurance coverage. The insurer's relationship to its participating policyholders, because of its duty to provide policyholders with an "at cost" price, is similar to that of a trustee to a beneficiary. A "participating policyholder," therefore, shares in the risks, costs and other experience related to other policies of the same class. Participating policies provide owners with vested rights in the organizational structure of the insurer.

17. Principal Life and Principal Mutual are successors to Bankers Life Company, which in 1986 changed its name to Principal Mutual Life Insurance Company. On June 24, 1879, Bankers Life Association was incorporated as a mutual benefit life assessment concern. Bankers Life Company ("Bankers Life") was incorporated in 1911, and the Association was transformed into a legal reserve or level premium mutual insurance company.

18. In 1969, Bankers Life filed Amended and Substituted Articles of Incorporation with the State of Iowa. The Bankers Life Articles of Incorporation (the "Bankers Life Articles") were a contract between the State of Iowa and Bankers Life (later, Principal Mutual Insurance Company). The Bankers Life Articles provided Bankers Life with state authorization to operate as a mutual life insurer, and also provided contractual rights, including ownership interests, to its participating policyholders.

19. Until July 1, 1998, the participating policyholders' contract rights including ownership interests were in Principal Mutual Insurance Company, which operated as a mutual life insurance company. After July 1, 1998, pursuant to the 1998 Reorganization, Principal Mutual Life Insurance Company was reorganized so that policyholders' contract rights and ownership interests were bifurcated between Principal Life and Principal Mutual.[3]

20. "Contract rights" has several meanings. Contract rights refer to rights granted policyholders as members by reason of provisions in the insurer's articles of incorporation and in the insurance policies. These membership contract rights or "membership interests" were assumed by Principal Mutual pursuant to the 1998 Reorganization.

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[3] Each person who was a "member" of the Principal Mutual Insurance Company automatically became a member of Principal Mutual, including both participating and non-participating policyholders, subject to stated limitations. However, participating policyholders have ownership interests which non-participating policyholders do not, including the right to share in returns of surplus through dividends, thus effectuating the purchase of their policies "at cost." *See* Principal Mutual By-Laws, Article VI.

These rights are being taken and impaired by the Conversion Plan. Contract rights also refer to the rights of each policyholder to receive the benefits and guarantees provided in their individual policies, e.g., contracted for death benefits. These obligations were assumed by Principal Life in the 1998 Reorganization. These rights have been generally preserved under the Conversion Plan, except for the third type of contract rights – the right to receive insurance at cost. These rights, together with membership rights, are being impaired by the Conversion Plan.

II. POLICYHOLDERS' CONTRACTUAL RIGHTS AND OWNERSHIP INTERESTS CANNOT BE TAKEN EXCEPT PURSUANT TO THE EXERCISE OF STATE POWER UPON THE PAYMENT OF JUST COMPENSATION

21. The Conversion Plan, if implemented, would demutualize Principal Mutual. As a result, the participating policyholders' ownership interests will be extinguished and the participating policyholders will not receive just compensation for such interests and rights.

22. Under the Conversion Plan, Principal Mutual will be converted to a stock company. The ownership rights of the participating policyholders will be extinguished, and in exchange, policyholders will receive common stock of PFG-DE, cash or policy credits. The Conversion Plan allocates compensation to policyholders for their ownership interests predicated on an actuarial formula which distributes approximately 75% of the consideration to the variable component, and approximately 25% going to the fixed component. The variable component considers not only historical contributions but *projected future* surplus contributions as well. Under the

variable component, the consideration owed participating policyholders for their ownership interests is not paid exclusively to participating policyholders but also is allocated to non-participating policyholders and to non-Members who have no right to share in the surplus.[4] An initial public offering ("IPO") is also planned. The Conversion Plan does not grant participating policyholders any preferential subscription rights in the IPO. The IPO proceeds will not reflect the value of the control premium owned by participating policyholders which is extinguished under the Conversion Plan.

23. On July 1, 1998, pursuant to the 1998 Reorganization Plan, the participating policyholders' ownership interests (which prior thereto, together with their contract rights, were all vested in Principal Mutual Insurance Company) became vested in Principal Mutual. The Conversion Plan would take those rights by extinguishing the participating policyholders' ownership interests without just compensation.

24. Principal does not have the power to unilaterally rescind or change participating policyholders' ownership interests and contract rights. Iowa Code § 508B.9. The State of Iowa has the governmental power to take property only for a public purpose and conditioned on the payment of just compensation.

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[4] The remaining 25% of the IPO proceeds is allocated pursuant to the fixed component of the allocation formula which allocates 100 common shares of PFG-DE, or in certain instances, cash or policy credits, to each person who is the holder of any insurance or annuity contract.

25. A conversion plan can be approved by the Insurance Commissioner only if it is "fair and equitable." Iowa Code § 508B.3 (2001). This section provides three (3) alternative "safe harbors," i.e., a conversion plan must be approved under the Iowa Code if it satisfies the requirements of any of the three (3) alternatives. It also provides that "[T]he commissioner may determine whether any other [conversion] plan proposed by a mutual company is fair and equitable to its policyholders." *Id.*

III. PRINCIPAL AND THE STATE OF IOWA AGREED TO USE THE STATE'S POWER TO TAKE PARTICIPATING POLICYHOLDERS' OWNERSHIP RIGHTS AND TO MODIFY PARTICIPATING POLICYHOLDERS' INSURANCE CONTRACTS

26. On March 31, 2001, Principal Mutual's Board of Directors approved the Conversion Plan.

27. Once finalized, the Conversion Plan would dissolve the ownership interests and contract rights of participating policyholders in Principal Mutual. If implemented, participating policyholders with ownership interests in Principal Mutual would be compensated through payment in cash, insurance policy credits, or common stock of PFG-DE, the entity which will ultimately result from the merger of Principal Mutual and certain of its subsidiaries.

28. A Notice of Public Hearing was mailed to participating policyholders on June 15, 2001, and a hearing on the Conversion Plan was held on July 25, 2001 before Theresa Vaughan, Iowa's Insurance Commissioner.

29. The Insurance Commissioner thereafter approved the Conversion Plan on August 28, 2001. A copy of the Insurance Commissioner's Findings of Fact, Conclusions of Law and Order (the "Opinion") approving the Conversion Plan is attached as Exhibit A. In her Opinion, the Insurance Commissioner concluded that the Conversion Plan was, *inter alia*, "fair and equitable to [Principal Mutual] and its eligible policyholders. . . . " Ex. A, Op. at p. 17. However, for reasons stated herein, the Conversion Plan unconstitutionally deprives participating policyholders of property without just compensation.

30. Participating policyholders presently have a 100% interest in Principal Mutual's surplus of $6,252,500,000 (*See* Conversion Plan, Consolidated Financial Statements, p.F-5) and in the enterprise value of Principal Mutual, and have liquidation rights in all assets of Principal Mutual. After demutualization, participating policyholders will no longer have liquidation or other ownership rights to these assets. Moreover, participating policyholders were charged and will be charged many millions of dollars in costs and expenses to enable Principal Mutual to convert participating policyholders' property interests without just compensation.

IV. IF THE CONVERSION PLAN IS IMPLEMENTED, PRINCIPAL WILL HAVE ACTED UNDER COLOR OF STATE LAW TO DEPRIVE PARTICIPATING POLICYHOLDERS OF PROPERTY RIGHTS SECURED BY THE FEDERAL CONSTITUTION, AND THEREFORE, WILL BE SUBJECT TO LIABILITY FOR THIS DEPRIVATION

31. If the Conversion Plan is implemented, Principal Mutual will violate the Fifth and Fourteenth Amendments

to the United States Constitution (unconstitutional taking of property), the Commerce Clause (U.S. CONST. art. I, § 8, cl. 3), and the Impairment of Contract Clause (U.S. CONST. art. I, § 10, cl. 1). Each of these constitutional violations provides the basis for a claim under 42 U.S.C. § 1983.

32. The Fourteenth Amendment provides that the government shall not take private property for public use without just compensation. The Impairment of Contract Clause insures that states will not pass any law impairing the obligations of contracts. U.S. CONST. art. I, § 10, cl. 1. A private actor, jointly participating with state actors, may be deemed to be a state actor under the U.S. Constitution.

33. Principal Mutual Insurance Company, whose rights and duties vis-a-vis participating policyholders are now vested in Principal Mutual and Principal Life, and the State of Iowa agreed Principal would operate as a mutual life insurance company. Participating policyholders thereby acquired substantial property rights under Principal Mutual's articles of incorporation (the "Principal Mutual Articles,") and the Bankers Life Articles, (the Principal Mutual Articles and the Bankers Life Articles, collectively, the "Articles"). Principal and the State of Iowa knew that if they rescinded or altered the Articles, participating policyholders' property rights would be impaired or destroyed.

34. Principal Life is a stock life insurance company operating within a mutual insurance holding company structure pursuant to the 1998 Reorganization. The Conversion Plan would convert Principal Mutual to a stock life insurance company. Ultimately, the participating policyholders' ownership interests and contract rights

will be extinguished in exchange for cash, policy credits or common stock of PFG-DE, the surviving entity.

35. The participating policyholders will not receive just compensation for their ownership interests if the Conversion Plan is implemented for at least the following reasons:

A. The Conversion Plan provides that all Eligible Policyholders will receive a fixed component of 100 shares of PFG-DE, which would be the surviving entity after demutualization, and, in addition, a variable component of shares determined by the "actuarial contribution method." Op. p. 13. This method considers not only the contribution each eligible policy is estimated to have made to Principal Life's surplus and asset valuation reserve, but, also *and* improperly, "*the contribution that such Policy is expected to make in the future. . . .* " *See* Op. at p. 6. Statement of Actuarial Opinion of Daniel J. McCarthy of Milliman & Robertson, Inc. dated March 31, 2001 (The "Actuarial Opinion") (emphasis added). The estimated future contribution is reduced to present worth at an undisclosed discount rate.

In addition, the actuarial contribution method improperly allocates consideration due participating policyholders to non-participating policyholders who have no right to share in it. *See* Actuarial Contribution Memorandum, Exhibit F to Conversion Plan.

The method results in the unconstitutional taking of participating policyholders' property rights because it wrongfully distributes their existing policy rights to others and that does not reflect their current respective interests. Among other things, the Conversion Plan will result in participating policyholders receiving less dividends than they are entitled to receive absent the Conversion Plan;

B. Principal Mutual's initial public offering (the "IPO") which is the primary contemplated funding mechanism to pay Eligible Policyholders, will fail to compensate policyholders for their "control premium." To the contrary, such shares will be priced at a discount to fair value because of new issue discounts, market uncertainties, underwriting costs, anti-takeover provisions of Delaware law, or other factors. In addition, such shares will be offered to underwriters (and their customers) with no preferential subscription rights to Eligible Policyholders, thus diluting the rights of Eligible Policyholders; and

C. The value of the participating policyholders' ownership interests are also diluted because the Conversion Plan defines Eligible Policyholders to include non-members, i.e., the holders of (i) Evidences of Insurance Coverage issued by Principal Life under group insurer policies or annuity contracts; and (ii) certificates of insurance issued "to persons who have exercised a portability or continuation option under any of Principal Life's group universal life insurance policies or group long term care insurance policies." Conversion Plan, Article VI, ¶ 6.1. On information and belief, these persons do not have membership rights and/or are non-participating and cannot constitutionally be provided shares in PFG-DE at the expense of members of Principal Mutual. Only the owner of the group policy is a Member, so at most, one fixed allocation should be made per group policy.

36. Through its Conversion Plan, Principal Mutual has proposed a method by which Iowa and Principal Mutual will take property rights granted to, and paid for by, participating policyholders under the Articles and their insurance policies. Iowa, acting through the Insurance Commissioner, has approved the Conversion Plan and deprived the participating policyholders of their ownership

interests and contract rights without just compensation. In approving the Conversion Plan, Principal Mutual shares Iowa's governmental power to take property, as a state actor, and has taken participating policyholders' rights without just compensation.

37. Iowa has the power to take participating policyholders' property *only* for a public purpose and upon the payment of just compensation. If the Conversion Plan is implemented, Iowa will have authorized Principal Mutual to use the state's power to take participating policyholders' ownership interests and contract rights. Principal Mutual thus has undertaken a traditional government function, the taking of property, to allegedly foster a purported governmental interest.

38. The Conversion Plan, if implemented, repudiates the participating policyholders' ownership interests without just compensation. Principal Mutual's Conversion Plan does not provide complete restitution and the decision of the Insurance Commissioner purports to relieve Principal of such obligations.

39. Defendants have acted under the color of state law in proposing and attempting to implement the Conversion Plan. Defendants, acting under the color of state law, seek to deprive participating policyholders of rights secured by Amendment XIV and Article I, Section 10 of the United States Constitution.

V. PRINCIPAL MUTUAL BECAME A STATE ACTOR UNDER IOWA'S CONVERSION LAW IN THE PROPOSED DEMUTUALIZATION

40. Under the Iowa Conversion Law, the Insurance Commissioner must review a conversion plan and approve it if she finds, *inter alia*, that it is fair and equitable to the mutual company and its policyholders. Iowa Code § 5.08B.2 (2001). In approving the Conversion Plan, the Insurance Commissioner was a joint participant in Principal Mutual's private decision to demutualize.

41. Iowa was not only a joint participant in Principal Mutual's private decision to demutualize but was also a joint participant in setting the value of the participating policyholders' contract rights and voting interests. In this connection, instead of valuing participating policyholders' ownership interests by the laws of the states under which the policy contracts were formed, Principal Mutual and the State of Iowa used only Iowa law (the Conversion Law) to value participating policyholders' ownership interests and contractual rights.

42. The decision whether Principal Mutual can demutualize, as required under state law, is a joint state/private actor decision. Neither Principal Mutual nor the State of Iowa can unilaterally compel demutualization. Principal Mutual and the other Defendants voluntarily joined and acted in concert with the state actor (the Insurance Commissioner).

43. Under the Iowa Conversion Law, the private and state actors are bound at the hip if demutualization is to be finalized. However, at all times, Principal Mutual had the complete freedom under state law to remain a mutual insurance company.

VI. THE STATE AND PRINCIPAL PARTICIPATED IN THE DECISION TO RESCIND THE APPLICABLE ARTICLES OF INCORPORATION WITHOUT PROVIDING JUST COMPENSATION OR PROTECTING PARTICIPATING POLICYHOLDERS FROM IMPAIRMENT OF THEIR CONTRACTUAL RIGHTS AND OWNERSHIP INTERESTS WITHOUT JUST COMPENSATION

44. In approving the Conversion Plan, the State of Iowa and Principal are, as "state actors," engaged in "taking" participating policyholders' property and, therefore, had a constitutional duty to provide participating policyholders "just compensation," which means the "fair market value" of the property at the time of the taking. Principal Mutual was obligated to provide complete restitution, under the laws of the state of the insurance contract delivery and under the United States Constitution, to participating policyholders for its repudiation of their property and contract rights. The Conversion Plan does not provide for the payment of just compensation at the time of taking, or under the state laws governing the taking (for policyholders residing in states outside of Iowa), but only discounted, diluted and unjust compensation.

A. The Value Provided Is Not Fair Value At The Time Of The Taking, As The Method For Allocating Shares Or Other Consideration Impairs Contractual Rights And Ownership Interests, Depriving Participating Policyholders Of Just Compensation

45. The Conversion Plan provides that, in exchange for their ownership interests and contract rights,

participating policyholders will be compensated through payment in cash, insurance policy credits, or the common stock of PFG-DE. However, the Conversion Plan utilizes a flawed allocation formula.

46. The Conversion Plan provides that each participating policyholder will be allocated compensation for his or her membership interests using an actuarial formula. The formula allocates compensation based on both a fixed component and a variable component. The fixed component allocates 100 common shares of PFG-DE, or in some instances, cash or policy credits, to both participating or non-participating policyholders on the Effective Date of the Conversion Plan and also allocates such shares, cash or policy credits to certain non-members.

47. The variable component allocates compensation based upon an actuarial formula, commonly referred to as an "Historical Plus" formula, purportedly intended to reflect each Eligible Policyholder's past *and expected future* contributions to Principal Mutual's surplus. The centerpiece of the variable component formula is a relatively recently adopted actuarial theory that allocates compensation based, in part, on *projected future* surplus contributions. The formula used by Principal also allocates a variable share to policyholders with no right to share in returns of surplus, i.e., to non-participating policyholders and to certain non-members, i.e., the holders of (a) Evidences of Insurance Coverage issued by Principal Life under a group insurer policy or annuity contract; and (b) certificates of insurance issued "to persons who have exercised a portability or continuation option under any of [Principal Life's] group universal life insurance policies or group long term care insurance policies." Conversion Plan, Article VI, ¶ 6.1.

48. The allocation formula is contrary to the participating policyholders' rights under the Articles. This is because the allocation formula was *not* based exclusively upon each participating policyholder's retrospective contributions to surplus, and historic practices which would require that the surplus and other benefits of ownership belong to the then existing participating policyholders based on the amounts of their contributions to surplus to date.

B. The Conversion Plan Impairs The Participating Policyholders' Substantial Contractual And Ownership Interests Without Just Compensation

49. Implementation of the Conversion Plan would breach participating policyholders' contractual rights under the Articles and their life insurance contracts, causing substantial damage. The Conversion Plan would impair these rights, including rights granted by Bankers Life Articles, Article VIII and Principal Mutual Articles, Article VII, §§ 7.4 and 7.5.

50. The Bankers Life Articles, which incorporate Iowa law, provide in Article VIII that Bankers Life (later, Principal Mutual Insurance Company) "shall have no capital stock, but shall be purely mutual as a reserve company." Under the Bankers Life Articles, participating policyholders owned a legal interest in the Principal Mutual Insurance Company. While the 1998 Reorganization bifurcated participating policyholders' rights between Principal Mutual and Principal Life, the totality of rights remained intact.

51. The Principal Mutual Articles did not authorize the Conversion Plan. To the contrary, they required that the fair value of Principal Mutual should be distributed proportionately to participating policyholders upon the dissolution, liquidation or winding up and dissolution of Principal Mutual. Principal Mutual Articles, Article VII, §§ 7.4 and 7.5. If implemented, the Conversion Plan will not proportionately distribute Principal Mutual's fair value to participating policyholders.

52. The Conversion Plan repudiates the Articles and participating policyholders' contractual and ownership rights because:

a. It negates Principal Mutual from continuing as a mutual company;

b. It terminates the participating policyholders' rights to their proportionate shares of Principal Mutual's surplus without just compensation by means of an improper allocation formula;

c. It terminates the participating policyholders' rights to their proportionate shares of Principal Mutual's surplus without just compensation by means of an overly broad definition of "Eligible Policyholders";[5]

d. It deprives participating policyholders of ownership rights by forcing the exchange of their

[5] The Conversion Plan's definition of "Eligible Policyholder" includes approximately 150,000 persons who should not be included, and who are included only through a recent amendment to Principal Mutual's By-Laws. Policyholder Information Booklet Summary, pp. 19-20.

their interests in Principal Mutual for less than just compensation; and

e. It vitiates participating policyholders' rights to receive insurance at cost by reducing future dividends from the amounts to which participating policyholders are contractually entitled to receive.

53. For the reasons stated above, the Conversion plan also fundamentally alters participating policyholders' contractual and/or property rights and fails to provide just compensation at the time of taking.

CLASS ACTION ALLEGATIONS

54. This class action is brought pursuant to Fed.R.Civ.P. Rules 23(a) and 23(b)(1), (b)(2) and (b)(3) on behalf of all members of Principal Mutual who are owners of participating life insurance policies of Principal Life issued on or before March 31, 2001. The class excludes the Defendants, their subsidiaries, affiliates, entities directly or indirectly controlling the foregoing, and the foregoing entities' officers and directors.

55. The Class is so numerous that it is impracticable to bring all individual class members before the Court. The exact number of class members is unknown, but can be determined from the records maintained by Defendants. In many instances, class members either are unaware that their claims exist or their individual damages would be too small to justify the costs of bringing suit individually against a multi-billion dollar insurer. When aggregated, however, class members' damages are large enough to justify this class action.

56. Common questions of both law and fact affect the rights of each member of the class, including, *inter alia*:

a. Did the approval of, and/or will the implementation of, the Conversion Plan constitute a taking of participating policyholders' property rights, in violation of the Fourteenth Amendment of the Constitution?

b. Will implementation of the Conversion Plan violate the Commerce Clause of the Constitution?

c. Does the Conversion Plan violate the Impairment Clause of the Constitution?

d. Did Defendants act under the color of state law within the meaning of 42 U.S.C. § 1983?

e. Does the Conversion Plan deprive participating policyholders of their property rights under the Takings Clause of the Fourteenth Amendment of the Constitution by using an actuarial allocation formula which improperly allocates value to estimated future contributions to determine the amount of their compensation?

f. Does the Conversion Plan deprive participating policyholders of their property rights under the Takings Clause of the Fourteenth Amendment of the Constitution by distributing surplus belonging to participating policyholders to non-participating policyholders and to non-members?

g. Does the Conversion Plan deprive participating policyholders of their property rights under the Takings Clause of the Fourteenth

Amendment of the Constitution by distributing surplus belonging to participating policyholders to non-participating policyholders by crediting an actuarial contribution to policyholders other than those policyholders who actually made the contributions to surplus under participating policies?

h. Does the Conversion Plan deprive participating policyholders of their property rights under the Takings Clause of the Fourteenth Amendment of the Constitution by compensating them based on an IPO which will not reflect a control premium price and without any subscription rights?

i. Did the state and the Defendants, acting individually and in concert, under 42 U.S.C. § 1983, unconstitutionally impair participating policyholders' contractual rights, as set forth in the Articles and their participating policies of insurance?

j. Does the Conversion Plan wrongfully require participating policyholders to pay millions of dollars in costs and expenses to enable Principal to convert without their just compensation?

k. Does the Conversion Plan wrongfully determine just compensation by the laws of Iowa for policyholders in other states where the insurance policies were delivered and formed?

57. Representative Plaintiff will assure the adequate representation of all class members. Her claims are typical of the class claims. She has no conflict with class members in the maintenance of this action, and her interests in this action are antagonistic to Defendants' interests. She will

vigorously pursue the class claims. She is aware that she cannot settle this action without Court approval.

58. Representative Plaintiff can acquire the financial resources to litigate this action. Moreover, undersigned counsel have agreed to pay all reasonable costs to litigate this action.

59. Undersigned counsel, Malakoff Doyle & Finberg, P.C. are experienced in litigating class actions in the state and federal courts including actions for and on behalf of other policyholders in insurance related cases. Thomas E. Greenwald and J.F. Heckinger are experienced in litigating class action lawsuits and have handled multiple such actions in state and federal courts on behalf of plaintiffs and plaintiffs' classes. Counsel are handling this case on a contingent basis and will receive compensation for their professional services only as awarded by the court.

60. A class action provides a fair and efficient method of adjudicating this controversy. The substantive claims of the Representative Plaintiff and the class members will require evidentiary proof of the same kind and application of the same law, since Defendants have treated all class members in a similar and/or identical manner.

61. There are no known unusual legal or factual issues which would cause management problems not normally and routinely handled in class actions. Because class members may be unaware that their rights have been violated, or, if aware, would be unable to litigate their claims on an individual basis because of their relatively small damages, a class action is the only practical proceeding. For the reasons stated above, the class should be certified pursuant to Fed.R.Civ.P. 23(a) and 23(b)(3).

62. The class should also be certified under Rule 23(b)(1) because the prosecution of separate actions by individual members of the class (A) would create the risk of inconsistent or varying adjudications with respect to individual members of the class which would establish incompatible standards of conduct for defendants, or which (B) would as a practical matter be dispositive of the interests of other class members or substantially impair or impede their ability to protect their interests.

63. The class should also be certified under Rule 23(b)(2) because the parties opposing the class have acted or refused to act on grounds generally applicable to the class thereby making appropriate final injunctive relief or corresponding declaratory relief with respect to the class as a whole.

STATEMENT OF THE CLAIMS

COUNT I

(Unconstitutional Taking Resulting from Valuing Participating Policyholders' Ownership Interests on the Historic Plus Allocation Method – Stating a Damage Claim Under Section 1983)

64. The foregoing paragraphs are incorporated.

65. The Fifth Amendment to the Constitution provides " . . . nor shall private property be taken for public use, without just compensation." The Fifth Amendment is applicable to the states under the Fourteenth Amendment. This "Takings" clause generally prohibits a state from taking property from one private party primarily for the purpose of benefitting another private party. Private

property can be taken and sold to another private party only when to do so serves a public use and only upon payment of just compensation.

66. Iowa and Principal Mutual agreed to take the ownership interests of participating policyholders and to transfer them to PFG-DE. Defendants fully participated with the State of Iowa to obtain this objective. This agreement fails to provide participating policyholders just compensation by reason of Principal's contract repudiations.

67. Although the Iowa legislature may alter or amend corporate statutes, and therefore, articles of incorporation, it can not defeat or substantially impair rights vested under such articles or grants without paying just compensation.

68. In 1985, the Iowa Legislature enacted a statute that authorized the conversion of an Iowa mutual life insurance company to an Iowa stock company. Iowa Code § 508B.1 et seq. (2001). Here, this law was applied retroactively to divest participating policyholders of their already vested interests in Principal Mutual's surplus and other assets.

69. The Conversion Plan allocates compensation based upon a formula that purportedly is intended to reflect each Eligible Policyholder's past and projected future contributions to Principal Mutual's surplus rather than allocating based on retrospective surplus contributions, as required by the Articles and insurance contracts and as has been the longstanding practice of the Mutual Insurance Company and, after July 1, 1998, Principal Mutual.

70. The participating policyholders have been damaged by not being provided just compensation and are therefore entitled to damages from Principal under 42 U.S.C. § 1983.

COUNT II

(Unconstitutional Taking Resulting from Distributing the Value of Participating Policyholders' Ownership Interests to Non-Participating Shareholders – Stating a Damage Claim Under Section 1983)

71. The foregoing paragraphs are incorporated.

72. The variable component of the allocation formula also improperly allocates consideration attributable to participating policyholders' rights to share the surplus and other value of Principal to persons not entitled to share in such returns by improperly attributing to non-participating policyholders an "actuarial contribution" credit.

73. The value of the participating policyholders' ownership interests are further improperly diluted because the Conversion Plan defines Eligible Policyholders to include non-participating policyholders and non-Members, including the holders of (a) Evidences of Insurance Coverage under a group insurance policy or annuity contract; and (b) certificates of insurance issued "to persons who have exercised a portability or continuation option under any of [Principal Life's] group universal life insurance policies or group long term care insurance policies." Conversion Plan, Article VI, ¶ 6.1.

74. The value of participating policyholders' ownership interests are being improperly diluted because their rights to receive insurance at cost, through the payment of dividends, are being impaired, and the amount of such dividends will be reduced as a result of the Conversion Plan.

75. The participating policyholders' interests are also being improperly diluted because they will not receive any premium for their controlling interest in the Principal defendants.

76. The participating policyholders have been damaged by not being provided just compensation and are therefore entitled to damages from Principal under 42 U.S.C. § 1983.

COUNT III

(Violation of the Commerce Clause)

77. The foregoing paragraphs are incorporated.

78. The Commerce Clause, Art. I, Section 8, clause 3 of the Constitution provides: "[T]he Congress shall have power to regulate commerce . . . among the several States." U.S. Const. Art. I, Sec. 8, cl. 3.

79. Participating policyholders are protected by the state laws where their policies were delivered and thereby formed. If the Conversion Plan is implemented and Principal is permitted to repudiate its contracts pursuant to the Conversion Plan, participating policyholders are entitled to complete restitution as provided by the state law where their policies were delivered.

80. Iowa's Conversion Law (pursuant to which the Conversion Plan was approved), fails to require that participating policyholders' restitution damages caused by the implementation of the Conversion Plan be determined by the law of damages under the state law where each policyholder's policy was delivered. Instead, it only provides that the Iowa Insurance Commissioner may approve any conversion plan which is "fair and equitable." Iowa Code § 508B.3 (2001).

81. States outside of Iowa have the primary interest in protecting insurance contracts entered into within their boundaries.

82. Principal's breaches of contract will occur in the state in which each policy was delivered and the contract formed, which for most class members was outside of Iowa.

83. The application of Iowa's Conversion Law to repudiate contractual rights granted participating policyholders under their policies violates the Commerce Clause of the Constitution, entitling participating policyholders (outside of Iowa) to recover damages from Defendants under 42 U.S.C. § 1983 under the laws of their own state.

COUNT V

(Unconstitutional Impairment of Contract – The Policyholders' Right to Vote)

84. The foregoing paragraphs are incorporated.

85. The Fifth Amendment of the Constitution provides that no state shall enact any "law impairing the obligations of contracts. . . ."

86. Under the Articles and their mutual participating policies, participating policyholders had ownership and control of Principal Mutual.

87. The implementation of the Conversion Plan impairs the rights of all participating policyholders.

88. The value of the participating policyholders' ownership interests are improperly diluted because the Conversion Plan defines Eligible Policyholders to include non-participating policyholders and even non-Members.

89. Principal's impairment of participating policyholders' right to vote with respect to the Conversion Plan and their ownership interest will cause participating policyholders damages.

90. Participating Policyholders are therefore entitled to recover damages from Defendants under 42 U.S.C. § 1983 for their repudiation of participating policyholders' shareholders' right to vote on the Conversion Plan and their ownership interests by the including of the rates of non-participating policyholders.

COUNT V

(Unconstitutional Impairment of Contract – The Mutual Surplus)

91. The foregoing paragraphs are incorporated.

92. Participating policyholders each paid for a participating policy in an Iowa mutual insurer. Principal Mutual was required to maintain books and accounts which apportioned net surplus annually. Principal Mutual's use of an "Historic Plus" method for distributing Principal Life's net surplus is (1) inconsistent with the

Articles and (2) inconsistent with Defendants' interpretation of the Articles over 90 years.

93. Defendants do not have the right to reallocate Principal Mutual's fair value based on a so-called "Historic Plus" method, which speculates as to surplus to be earned in the future and negates the allocation of surplus in fact earned in the past.

94. Defendants also do not have the right to use an allocation formula which improperly allocates consideration to non-participating policyholders, and to non-Members, who have no right to share in returns of surplus by crediting an actuarial contribution to policyholders who have no rights with respect to such surplus and/or made no contributions to surplus.

95. Defendants do not have the right to impair participating policyholders' rights to receive insurance at cost through the payment of dividends.

96. In addition, the participating policyholders' rights to proportionately share in the surplus are or will be wrongfully diluted because the Conversion Plan defines "Eligible Policyholders" to include non-participating policyholders and non-Members.

97. Participating policyholders are therefore entitled to recover damages from Defendants under 42 U.S.C. § 1983 for Principal Mutual's repudiation of the participating policyholders' interests.

REQUEST FOR RELIEF

WHEREFORE, for the foregoing reasons, Representative Plaintiff respectfully requests that a declaratory

judgment be granted in her favor and in favor of other participating policyholders against Defendants Principal Mutual Holding Company, Principal Life Insurance Company, Principal Financial Group, Inc., Principal Financial Services, Inc., Principal Iowa Newco, Inc. and Principal Financial Group, Inc. finding (a) that the Insurance Commissioner's approval of the Conversion Plan constitutes the taking of the participating policyholders' ownership interests and contract rights without "just compensation," and is thus an unconstitutional "taking" and "impairment" of the participating policyholders' ownership interests and contract rights, in violation of the "Takings Clause" of the Fifth and Fourteenth Amendments, the Commerce Clause, Article 1, Section 8, clause 3, and the "Impairment Clause" of Article I, Section 10 of the Constitution; and (b) that Defendants are jointly and severally liable to Representative Plaintiff and the Class for damages and such other relief as may be appropriate.

A JURY TRIAL IS REQUESTED.

Respectfully submitted,

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DATED: September 27, 2001

APPENDIX H

BEFORE THE INSURANCE COMMISSIONER
OF THE STATE OF IOWA

In the matter of the application of PRINCIPAL MUTUAL HOLDING COMPANY, for approval of a plan of conversion from a mutual insurance holding company into a stock company	)))))))	FINDINGS OF FACT, CONCLUSIONS OF LAW, AND ORDER

I. INTRODUCTION

Principal Mutual Holding Company (PMHC or the company) is an Iowa domestic mutual insurance holding company (MIHC) organized under Iowa Code section 521A.14 and Iowa Code chapter 491. PMHC is the product of the July 1, 1998 reorganization of Principal Mutual Life Insurance Company into a stock life insurance company operating within an MIHC structure. Materially related to PMHC are the following companies:

1. Principal Financial Group, Inc. (PFGI-IA), an Iowa intermediate holding company and a wholly owned subsidiary of PMHC.

2. Principal Financial Services, Inc. (PFSI), an Iowa intermediate holding company and a wholly owned subsidiary of PFGI-IA.

3. Principal Life Insurance Company (PLIC), an Iowa domestic stock life insurance company and a wholly owned subsidiary of PFSI.

4. Principal Iowa Newco, Inc. (PINI), an Iowa business corporation (currently a subsidiary of PMHC) and a wholly owned subsidiary of Principal Financial Group, Inc. (PFGI-DE), a Delaware corporation.

PMHC wishes to convert from a domestic MIHC into a stock company. As a consequence the Iowa Commissioner of Insurance (the Commissioner) conducted an examination of the company and its affiliates under Iowa Code sections 521A.6(1) and 507.2 (2000). Sections 521A.6(2) and 507.3(4) permit the Commissioner to retain – at the examinee's expense – advisory consultants regarding examination issues. Section 508B.2 requires a mutual company to reimburse the state for expenses incurred by the Iowa Insurance Division (the Division) in connection with a conversion elected under that provision. The Commissioner retained the following consultants for the PMHC examination and conversion issues: (1) Arthur Anderson LLP (AA) for actuarial and accounting issues; (2) The Blackstone Group L.P. (Blackstone) for investment banking issues, and (3) Baker & Daniels (B & D) for legal issues.

PMHC retained advisory consultants for conversion issues as well: (1) Milliman USA, Consultants and Actuaries, f/k/a Milliman & Robertson, Inc. (Milliman) for actuarial issues, (2) Ernst & Young (E & Y) for accounting issues, (3) Goldman Sachs & Co. (Goldman) for financial issues, and (4) Debevoise & Plimpton (Debevoise) for legal issues.

PMHC's Board of Directors approved (unanimously) a Plan of Conversion (the Plan) for the company on March

31, 2001. Iowa Code chapter 508B requires dual approval of a proposed plan of conversion by (1) the converting company's policyholders,[1] and (2) the Commissioner.

Section 508B.6 requires policyholder approval of a proposed plan. Approximately 92% of PMHC's policyholders voting approved the Plan and other related transactions at a special policyholder's meeting on July 24th, 2001.[2]

Section 508B.7 requires Commissioner approval of a proposed plan. On May 29, 2001, PMHC filed with the Commissioner (1) an Application for Approval of the Plan (Application), (2) the Plan, and (3) relevant attached exhibits. A Supplemental Application was filed with the

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[1] Iowa Code section 508B.7 directs the Commissioner to assess whether a plan of conversion is fair and equitable to "policyholders." Because PMHC is a mutual holding company, it has no policyholders. Rather, it has "members", who will be given certain compensation for extinguishing their membership interests in PMHC if the proposed plan of conversion is approved. PMHC's members are present and certain former PLIC policyholders, as more fully explained in footnote 6. However, for ease of reference, this Order will refer to PMHC's members as policyholders.

For the purposes of this proceeding, the Commissioner will construe the statute to require an assessment of the fairness and equity of the Plan as it relates to PMHC's policyholders. This construction is consistent with the statutory intent of Iowa Code sections 521A.14(5)(b) and 508B.7, which seek to protect the interests of policyholders/members of mutual companies.

[2] Approximately 30% of the PMHC policyholders eligible to vote did so. Section 508B.6 requires approval by a 2/3 majority of votes cast, as opposed to a 2/3 majority of votes eligible to be cast.

Commissioner on or about June 8, 2001, along with supplemental exhibits.[3]

If approved, the Plan effects the following structural changes to PMHC and its wholly-owned subsidiary companies on the effective date of the Plan:

1. PMHC is converted from an MIHC into a stock company;
2. PMHC is merged with and into PINI;
3. PFGI-IA is merged with and into PINI;
4. PFSI is merged with and into PINI; and
5. PINI's name is changed to Principal Financial Services, Inc. (the reorganized company).

The conversion and the mergers described above are collectively referred to as the "restructuring." Upon completion of the restructuring, PFGI-DE will be the indirect parent company of PLIC. Also on the effective date of the Plan, PFGI-DE will complete its initial public offering (IPO) of shares of its common stock to the public.

Under the discretion afforded by Iowa Code section 508B.7, the Commissioner ordered a public hearing on the fairness and equity of the terms of the Plan after giving the written notice of hearing required by this section to PMHC, its policyholders, and other known interested persons. Notice to PMHC policyholders was mailed over a several day period ending June 15, 2001, as part of an informational packet concerning the proposed conversion.

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[3] For ease of reference, Application and Supplemental Application will be referred to herein simply as Application.

Notice was also published in three newspapers (the Des Moines Register, USA Today national edition, and the New York Times national edition) on June 13, 2001 and was posted on PMHC's and the Division's Websites.

The public hearing on the Plan was held on Wednesday, July 25, 2001. PMHC appeared, submitting testimonial and documentary evidence in support of the Application, the Plan and attached exhibits. The Division also presented evidence, as did several PMHC policyholders and other members of the public. Submitted as well were written member and public comments and other documents received by the Division through the date of the hearing.

The Commissioner adjourned the day-long public hearing at the close of testimony and statements. The administrative record closed at this point for all submissions save one: The record was held open for the limited purpose of admitting company officer and director biographical information. Upon the Commissioner's receipt of these documents on Monday, July 30, 2001, the administrative record was formally closed. With the exception of these documents, information received by the Commissioner after the close of the July 25 hearing was not included in the record and not considered in the Commissioner's deliberations.

II. JURISDICTION

Statutory authority for regulating mutual insurance holding companies is generally found in Iowa Code section 521A.14 and 191 Iowa Administrative Code 46 ("Mutual Holding Companies"). Section 521A.14(5)(b) provides that Iowa Code chapter 508B, Conversion From a Mutual

Company to a Stock Company, applies to the demutualization of an MIHC that results from the reorganization of a domestic mutual life insurance company.[4]

PMHC elected to develop a demutualization plan under the Iowa Code section 508B.2 provision allowing an MIHC to convert to a stock company "pursuant to a plan approved by the Commissioner." Section 508B.7 directs the Commissioner to review any proposal for conversion of a mutual company to a stock company. This provision requires the Commissioner to approve a plan if the Commissioner finds that (1) the plan complies with all provisions of law, (2) the plan is fair and equitable to the mutual company and its policyholders, and (3) the reorganized company will have the amount of capital and surplus deemed by the Commissioner to be reasonably necessary for its future solvency.

III. EVIDENCE PRESENTED

Hearing testimony and documentary evidence admitted into the record regarding the Plan are summarized as follows:

A. ***PMHC***. The company presented four witnesses in support of the Application and Plan: (1) David J. Drury, Chairman of the company, (2) Karen E. Shaff, Senior Vice President and General Counsel of the company, (3) Daniel J. McCarthy, a consulting actuary with Milliman, and (4)

[4] On May 15, 1998, the former Principal Mutual Life Insurance Company received approval from the Commissioner to reorganize as the present PMHC.

Celeste A. Guth, a managing director with Goldman. As noted above, Milliman and Goldman are PMHC's actuarial and financial advisors, respectively, regarding the conversion issues in this matter.

1. David J. Drury. In his position as PMHC Chairman, Mr. Drury was responsible for providing overall guidance in the development of the Plan. He testified at length, fielding a wide variety of questions concerning the proposed conversion.

Mr. Drury provided a contextual background for PMHC's demutualization decision. He affirmed that reorganizing into an MIHC in 1998 has served the company well and helped PMHC to accomplish many things in a short period of time, but noted that changes in the financial services industry since PMHC was organized in 1998 have created competitive pressures warranting further restructuring of the company. (Drury testimony at p. 22.). Although PMHC is financially strong, these changes since PMHC's creation led its Board of Directors (Board) and management to conclude that the strength and future of the organization would be enhanced through a full demutualization. (*Id.* at 23.).

During the course of his testimony, Mr. Drury described the potential benefits demutualization under the Plan will provide to the reorganized company and to its policyholders. He testified that PMHC's Board believes that the demutualization would enhance the company's financial flexibility to raise additional capital and pursue its strategies and operating principles. He also discussed some of the key elements of the Plan, including, but not limited to, the form, method of

allocating, and distribution of eligible policyholder compensation, the IPO and the potential for other capital raising transactions, subscription rights, and restrictions on PMHC's equity-based compensation awards for officers and employees and acquisition of stock by officers. (Drury testimony at pp. 15-87.).

2. Karen E. Shaff. As Senior Vice President and General Counsel of the company, Ms. Shaff addressed certain business and legal aspects of the Plan and stated how the applicable legal requirements for Plan approval have been satisfied. She testified to PMHC's compliance with the relevant Iowa Code provisions and to certain federal issues relating to the proposed demutualization. (Shaff testimony at pp. 87-115.).

3. Daniel J. McCarthy. Mr. McCarthy is a consulting actuary at Milliman with extensive demutualization experience. He supervised Milliman's work as PMHC's actuarial adviser in connection with the demutualization. Mr. McCarthy testified about the substance of his actuarial opinion delivered on March 31, 2001, to PMHC's Board regarding the fairness of the Plan. (McCarthy testimony at pp. 116-151.). He specifically stated that (1) PMHC's principles, assumptions and methodologies used to allocate compensation among the eligible policyholders (as defined in section IV(A)(1) below), as set forth in the Plan, are reasonable and appropriate, and (2) employment of these assumptions and methodologies result in an allocation of compensation that is fair and equitable to eligible policyholders. (*Id.* at pp. 122-32.).

Additionally, Mr. McCarthy explained that PLIC's closed block, established in 1998 coincident with the reorganization of Principal Mutual Life Insurance Company into PMHC, will continue to operate according to its terms as originally established. (McCarthy testimony at pp. 126-27.).

4. Celeste A. Guth. Ms. Guth is a managing director of Goldman and has extensive demutualization experience. She testified about the types of review and procedures undertaken by Goldman in connection with the March 31, 2001, delivery of an opinion to PMHC's Board that the exchange of the aggregate membership interests in the company for shares of PFGI-DE common stock, cash or policy credits in accordance with the Plan is fair, from a financial point of view, to eligible policyholders, taken as a group. (Guth testimony at pp. 157-66.). In addition to providing a fairness opinion to PMHC, Ms. Guth testified that under the terms of Goldman's engagement, Goldman expects to serve as sole book-running lead manager or sole book-running agent in the case of any offering or placement of securities which occurs within 30 days of the demutualization, including the initial public ofering or any other capital raising transactions. (Guth testimony at pp. 156-57.).

PMHC also presented documentary evidence. The following PMHC documents were offered and admitted into the record without objection:

1. A copy of the Plan, together with its exhibits.

2. Copies of policyholder materials mailed to PMHC policyholders, including policyholder

information booklets Parts I and II, a policyholder guide, and other materials.

3. A statement of actuarial opinion of Daniel J. McCarthy, dated March 31, 2001.

4. A Goldman opinion letter, dated March 31, 2001.

5. A Debevoise tax opinion, dated May 24, 2001.

6. An affidavit of mailing regarding policyholder materials.

7. An affidavit of publication regarding notice of the hearing.

8. A certification regarding the July 24th, 2001 special policyholders meeting vote.

9. Documents summarizing Goldman's experience in connection with certain insurance company reorganizations and stock offerings.

10. Guidelines for implementation of the continuous membership requirement under the Plan.

11. A memorandum concerning consideration of a top-up provision, dated March 15, 2001.

12. A memorandum concerning consideration of a subscription rights offering, dated March 15, 2001.

13. A pending litigation memorandum dated March 31, 2001.

14. Letters dated April 27, 2001 and June 1, 2001, concerning limitations on stock-based compensation under Plan section 8.1(d)(iii).

15. A letter dated July 16, 2001, concerning a voluntary deferral program for the Board.

16. A letter dated March 19, 2001, concerning the impact of the Groves litigation settlement on the closed block.

17. A certificate concerning amendment of the company's bylaws in March 2001 regarding eligibility for consideration.

18. A plan of operation for the stock separate account, dated April 20, 2001.

19. A certification concerning guidelines for the operation of the stock incentive plan, dated June 5, 2001.

20. A form of letter sent to former policyholders not receiving alerting letters concerning possible demutualization with reinstatement offer.

21. A form of letter concerning preparation of revised estimates of share allocations.

B. ***The Division.*** At the conclusion of PMHC's presentation the Division offered testimony and written documentation by its actuarial and financial experts.

1. **Darryl G. Wagner, FSA, MAAA.** Mr. Wagner is a partner with AA and has extensive demutualization experience. He discussed certain actuarial aspects of the proposed conversion, based upon the fairness opinion letter prepared for the Division by Mr. Wagner. His primary focus was AA's review of the proposed allocation of

eligible policyholder compensation under the Plan. Specifically, the Division requested Mr. Wagner to express an opinion on two issues: (1) the reasonableness and appropriateness of the actuarial methods and underlying assumptions used to determine the allocation of both the fixed and variable components of eligible policyholder compensation, and (2) the reasonableness of the resulting allocation of compensation and its fairness and equity from an actuarial perspective. (Wagner testimony at pp. 230-31.).

Mr. Wagner testified that to evaluate the fixed component of policyholder compensation, AA reviewed actuarial standards of practice, information regarding prior demutualizations in the United States, the company's historical voting policy, and relationships between the fixed component of policyholder compensation and the variable component of policyholder compensation. (Wagner testimony at p. 231.). To evaluate the variable component of policyholder compensation, AA reviewed the company's actuarial contribution methods and underlying assumptions, as the actuarial contribution results formed the basis for determining the variable component of compensation. (*Id.*).

Mr. Wagner concluded his testimony by stating his opinion: First, the actuarial methods and underlying assumptions used in the allocation of compensation, as described in the Plan and the actuarial contribution memorandum, are reasonable and appropriate. Second, the resulting allocation of compensation is reasonable, fair and equitable from an actuarial perspective and takes into account the proportional contribution to PLIC's surplus and asset valuation reserve of each class of policyholders. (*Id.* at 232-33.). Mr.

Wagner submitted for the record a written copy of his opinion, which was admitted without objection.

2. Martin Alderson Smith. Blackstone Senior Managing Director Martin Alderson Smith also testified. Mr. Alderson Smith has extensive demutualization experience. He discussed certain financial issues involved in the proposed conversion, and summarized the key assumptions, limitations and findings of a fairness opinion letter prepared by Blackstone at the Division's request.

Mr. Alderson Smith outlined in detail the review procedures Blackstone undertook as financial advisor to the Commissioner. These review procedures included, but were not limited to, an independent evaluation of the Plan, certain Form S-1 Registration Statements, PMHC's Strategic Plan for 2001, PMHC's financial projections for the years 2001 and 2002, certain of PMHC's proposed equity compensation plans, PMHC's proposed shareholder rights plan, PMHC's proposed dividend policy and estimates, prepared by PMHC, of the numbers of shares of common stock (and the number of policyholders eligible to receive such common stock) for which policy credits or cash will be given in lieu of the issuance of common stock. (Alderson Smith testimony at pp. 244-48.).

Based upon his review Mr. Alderson Smith concluded that, as of July 25, 2001, the Plan, taken as a whole, is fair to eligible policyholders as a group from a financial point of view. (*Id.* at 248.). Mr. Alderson Smith submitted for the record a written copy of Blackstone's opinion, which was admitted without objection.

C. ***PMHC Policyholders/Public/Other Submissions:*** Several PMHC policyholders and members of the public asked questions, made statements, and offered documents into evidence. In addition, numerous inquiries, letters, statements, notes and other documents relating to the Plan were submitted to the Division by PMHC policyholders, members of the public, and others through the July 25th hearing date. These latter items were formally admitted into the hearing record as well, and were carefully considered by the Commissioner in determining whether the Plan should be approved.

IV. FINDINGS OF FACT

Based upon PMHC's Application, the Plan and attached exhibits, the witness testimony and documentary submissions admitted into the hearing record, PMHC policyholder and public statements and documents admitted into the hearing record, as well as all other filings of record relevant to the above-captioned matter, the Commissioner finds as follows:[5]

A. PMHC'S PLAN TO CONVERT FROM A MUTUAL INSURANCE HOLDING COMPANY TO A STOCK COMPANY COMPLIES WITH ALL PROVISIONS OF LAW

Iowa Code section 508B.7 requires a plan of conversion to "compl[y] with all provisions of law." In this particular

[5] In her findings regarding Plan fairness to PMHC and its policyholders, the Commissioner relied primarily upon the opinion of Blackstone and the testimony of Mr. Alderson Smith and Mr. Wagner's opinion and testimony.

instance several Code provisions must be satisfied for Plan approval:

1. ***Policyholder eligibility***. Iowa Code section 508B.4 controls policyholder eligibility for demutualization compensation. An eligible policyholder generally is defined as someone who owns a policy one year before a plan is adopted, and who has a continuous membership interest in a converting mutual through ownership of one or more policies from one year before the plan is adopted until and on the effective date of the plan. PMHC's Board unanimously adopted the Plan on March 31, 2001. As Mr. Drury and Ms. Shaff testified, the Plan treats as eligible policyholders those persons who owned a PLIC policy or annuity contract on March 31, 2000, and who have a continuous membership interest in PMHC through ownership of one or more PLIC policies or contracts from March 31, 2000, until the effective date of the Plan. (Drury testimony at p. 28; Shaff testimony at p. 97.).[6] The Plan definition of eligible policyholder complies with the requirements of section 508B.4.

2. ***Policyholder notice packages***. Ms. Shaff detailed the process PMHC followed in preparing and mailing member notice packages. The record reveals that timely and proper notice of the special policyholders meeting and the public hearing on the proposed demutualization were

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[6] In addition, because of a 1980 change in the organization's articles of incorporation, eligible policyholders include those policyholders who were issued a PLIC policy or contract on or before April 8, 1980, and who transferred ownership rights of that policy or contract on or before April 8, 1980, as long as that policy or contract remains in force until the effective date of the Plan. (Drury testimony at p. 29.).

given through mailing of the policyholder notice packages to the PMHC policyholders eligible to vote, as required by Iowa Code sections 508B.2, 508B.4, and 508B.6. These were sent by priority mail to each voting policyholder's address as it appears on PMHC's records, which is consistent with PMHC's bylaws as section 508B.6 requires. (Shaff testimony at pp. 92-93.). Section 3.3 of the Plan incorporates these provisions. The Plan complies with the policyholder notice requirements of sections 508B.2, 508B.4, and 508B.6.

3. ***Policyholder approval.*** As already noted, section 508B.6 requires policyholder approval of a plan by two-thirds of those voting, and the Plan vote occurred at the special policyholders meeting on the day before the public hearing. Mr. Drury and Ms. Schaff provided the voting results during their testimony, which is confirmed by hearing exhibit 8: Of the total votes cast, 260,850 policyholders voted for approval of the Plan; 22,085 policyholders voted against approval of the Plan. (Drury testimony at pp. 25-26; Shaff testimony at p. 91; hearing exhibit 8.). This translates to approximately 92% approval by policyholders eligible to vote who did so, well over the statutory two-thirds requirement.[7] The Plan complies with the policyholder approval requirements of section 508B.6.

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[7] Ms. Shaff testified that approximately 13,000 mailings – less than 2% of the total policyholder mailings – were returned as undeliverable. (Shaff testimony at p. 104.). When asked what happens to the compensation allocated to policyholders that were unable to be located, Ms. Shaff stated that those policyholders receive mandatory cash compensation, as opposed to any other default compensation under the Plan. This money will be held for distribution to them through the unclaimed property provisions of the various states. (*Id.* at pp. 114-15.).

4. ***Reimbursement of Division expenses.*** Iowa Code section 508B.2 provides that if a mutual company elects under section 508B.2 to convert to a stock company under a plan approved by the Commissioner rather than under one of the specific methods otherwise set forth in chapter 508B, the mutual company shall reimburse the state for expenses incurred by the Division in connection with the conversion plan, except for expenses that are normal operating expenses of the Division. Ms. Shaff summarized this arrangement in her testimony. (Shaff testimony at pp. 100-01.). Section 8.8 of the Plan expressly incorporates this requirement. The Plan meets the reimbursement provisions of section 508B.2.

5. ***Restrictions on PMHC director, officer, agent, or employee compensation.*** Iowa Code section 508B.8 states that a director, officer, agent, or employee of a mutual company shall not receive a fee, commission, or other valuable consideration, other than regular salary and compensation, for aiding, promoting or assisting in a conversion, except as set forth in a plan of conversion. Plan section 8.2 specifically incorporates these restrictions. PMHC represented through Ms. Shaff's testimony that no such payments had been made to the date of the hearing, and that none would be made in the future. (Shaff testimony at p. 101.). The Plan complies with the section 508B.8 restrictions.

In addition, PMHC has represented to the Division and to policyholders in Policyholder Information Booklet I and Plan sections 5.3 and 7.4 that prior to the effective date of the Plan, it will have complied with, sought relief from, or

obtained exemptions from certain federal requirements impacting the demutualization.[8]

No legal requirement for Plan approval appears unsatisfied of record. Substantial evidence supports the finding that the Plan complies with all provisions of law.

B. THE PLAN IS FAIR AND EQUITABLE TO PMHC AND ITS POLICYHOLDERS.

Iowa Code section 508B.7 requires that a plan of conversion be fair and equitable to the mutual company and its policyholders.

1. ***The Plan is fair and equitable to PMHC.*** Most relevant to this finding is the testimony of Mr. Drury, Ms. Shaff, and Mr. McCarthy. As Mr. Drury testified, converting to a stock company positions the reorganized company for accelerating the growth of the United States asset accumulation business, growing third party institutional assets under management, and increasing the growth and profitability of international operations. (Drury testimony at pp. 23-24.).

Not the least of these objectives expounded upon by PMHC's witnesses is increasing capital access for the reorganized company. (Drury testimony at p. 23.). Mr. Drury reiterated that demutualization presents new venues for capital access. (Drury testimony at p. 23.). Mr.

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[8] In the event any new issues arise concerning these requirements, PMHC will inform the Commissioner. She will take the matter under advisement and take whatever action is appropriate under the circumstances.

Drury emphasized that demutualization creates enhanced access to the capital markets. (*Id.* at p. 23.). New venues and enhanced access in turn promote capital raising flexibility unavailable to MIHCs. (*Id.* at pp. 23-24.). Additional flexibility creates new opportunities for the reorganized company to strengthen its financial position. (*Id.*). The ability to invest in new technology and products – resulting in better customer service – will be heightened. (*Id.* at 24.). All of these opportunities that a demutualization creates would accrue to the benefit of the reorganized company and PLIC.

The testimony of the company's representatives is the best evidence of whether demutualization will be fair and equitable to PMHC. PMHC's witnesses testified: (1) Commissioner approval of the Plan will create significant business opportunities for the reorganized company; and (2) conversion will enhance the reorganized company's ability to achieve legitimate business goals. Both are positive outcomes. Demutualization is fair and equitable to PMHC.

2. ***The Plan is fair and equitable to PMHC's policyholders***. Evidence was admitted concerning the fairness of several discreet Plan subissues, as well as the overall fairness of the Plan. Subissues addressed on the record and discussed herein include: (a) subscription rights, (b) allocation of policyholder compensation, (c) the effect of demutualization on PLIC and the closed block, (d) fairness of the IPO price and the reasonableness of the IPO process, and (e) the commission-free sales program.

(a) ***Subscription rights***. Subscription rights allow an eligible policyholder to purchase newly issued stock at the IPO price on a preferential basis. Absent a subscription

rights program, it is unlikely that many policyholders would be able to receive an allocation of shares in the IPO. Much of the policyholder and public comment at the hearing and in written submissions through the hearing date expressed concern about this issue.

Iowa law does not require that a proposed plan of conversion include subscription rights. Whether inclusion of a subscription rights provision is warranted is an equitable decision, made case by case based upon the facts presented. The Plan does not provide for subscription rights or alternative methods by which eligible policyholders could purchase stock at the IPO price.

The company considered and rejected incorporating a subscription rights provision, concluding the costs and risks to eligible policyholders associated with such an offering outweigh the benefits. (Drury testimony at pp. 49-51.). The specific arguments are contained in the March 15, 2001 memorandum of record and reiterated in Mr. Drury's testimony. (Hearing exhibit 12.). The preeminent negative considerations for PMHC were that (1) offering subscription rights would be costly, (2) these costs would unfairly be borne by all policyholders, (3) it is likely that only a few policyholders would participate in, and benefit from, purchasing at the IPO price, (4) offering subscription rights would add complexity to the IPO process, and (5) offering subscription rights could increase IPO execution risk and potentially negatively affect the IPO price, which would be detrimental to all eligible policyholders (because their compensation is based on the IPO price). (Drury testimony at pp. 50-51.).

These observations are substantiated by Mr. Alderson Smith's testimony. He testified that a plan of conversion

can potentially be fair with or without subscription rights, noting that the Plan does not provide for subscription rights. (*Id.* at p. 251.). In the course of its review, Blackstone considered the pros and cons associated with including a subscription rights program. Mr. Alderson Smith delineated a number of the important benefits offering subscription rights affords. (Alderson Smith testimony at pp. 252-53.). He noted as well all of the negatives addressed by Mr. Drury, adding one additional risk factor: Offering subscription rights may result in less stock being delivered into the institutional market. (Alderson Smith testimony at p. 255.). A strong institutional market is important for a stable after-market trading performance for the company's stock. (*Id.*) Less stock held by institutional investors may increase the risk of unstable trading patterns post-IPO. (*Id.*). Overall, and in the context of the Plan as a whole, Blackstone concluded that the cons associated with a subscription rights offering outweighed the pros making the absence of a subscription rights provision in this particular circumstance reasonable. (*Id.* at 255-56.).

The facts of this particular reorganization establish that PMHC's decision to forego offering subscription rights in the Plan is appropriate. Evidence of record favoring inclusion of subscription rights is insufficient to overcome this finding. The Plan is fair and equitable to eligible policyholders without the inclusion of a subscription rights program.

(b) ***Value and allocation of eligible policyholder compensation***. Under the Plan, eligible policyholders will receive the entire pre-IPO value of PMHC in the form of PFGI-DE common stock, or its equivalent value in cash or policy credits, in exchange for their membership interests

in the company. In his testimony, Mr. Alderson Smith detailed the review process undertaken by Blackstone, concluding that the Plan taken as a whole is fair to the eligible policyholders as a group from a financial point of view. (Alderson Smith testimony at p. 248.). Blackstone's opinion is part of the record. The Commissioner believes that Blackstone's opinion and Mr. Alderson Smith's corroborating testimony provide substantial evidence that the aggregate value to be distributed to eligible policyholders as compensation for extinguishing their membership interests in PMHC is fair and equitable to the eligible policyholders as a group.

Under the Plan, compensation will be allocated in two parts. All eligible policyholders will receive a fixed component of 100 shares (subject to proportional adjustment). Each eligible policyholder may also receive a variable component of shares, the number of which will be computed under an actuarial calculation method that will be applied to each eligible policyholder. (McCarthy testimony at pp. 127-28; Drury testimony at pp. 30-31; Plan at pp. 22-23.). The Iowa Code does not require the use of any specific allocation method(s) in calculating each eligible policyholder's compensation. (McCarthy testimony at p. 124.).

The fixed share allocation comprises roughly one-fourth of the total consideration to be distributed in the conversion. This allocation method and the proposed distribution of 100 shares under this method are reasonable and appropriate. (McCarthy testimony at pp. 128-29; McCarthy opinion at p. 3; Wagner opinion at pp. 234-35.). Distribution of a fixed share allocation rewards eligible policyholders for simply being policyholders. It assures that eligible

policyholders, no matter how their policies have performed, will receive a threshold level of compensation as a result of demutualization for extinguishing their membership interest in PMHC. It recognizes that eligible policyholders have certain interests – for example, voting rights – which are independent of the actuarial contribution of their policies. Furthermore, the instant allocation is within the range of fixed component allocations distributed in prior demutualizations of MIHCs (although at the higher end of the range). (McCarthy testimony at p. 133.).

All of the remaining compensation allocated to eligible policyholders will be allocated through the variable component. The number of variable shares allocated to each eligible policyholder will be determined by using the actuarial contribution method. (McCarthy testimony at p. 124.). Under this method, eligible policyholders will receive a variable component if the actuarial contribution of their policies had a positive value as of March 31, 2000 and they continue to have a membership interest on the effective date of conversion. (*Id.* at pp. 123-24, 132.). The ultimate number of shares each eligible policyholder receives under the variable component will be determined pro rata, based upon the amount of positive actuarial contribution of their eligible policies on March 31, 2000. (*Id.* at 123-24.).

Mr. McCarthy testified that using the actuarial contribution method to calculate the variable share allocation for eligible policyholders is reasonable and appropriate. (McCarthy testimony at p. 125; McCarthy opinion at p. 2.). The actuarial contribution method is recognized within the actuarial profession as an appropriate allocation method in demutualizations. (McCarthy testimony at pp. 124-25.). Actuarial Standard of Practice 37, adopted in December

2000, is the most authoritative professional guidance available to actuaries on variable allocation. (*Id.*). It clearly states in relevant part, "The variable component of consideration should be allocated on the basis of actuarial contribution." (*Id.* at 125.).

Mr. McCarthy's opinion and his supporting testimony on the appropriateness of the allocation of the fixed and variable consideration components are substantiated by the fairness opinion submitted by Mr. Wagner, as well as by Mr. Wagner's testimony. At the Division's request, AA reviewed Mr. McCarthy's opinion in conjunction with the Plan. Mr. Wagner opined that (1) the actuarial methods and underlying assumptions used in the allocation of compensation as described in the Plan and PMHC's actuarial contribution memorandum are reasonable and appropriate; and (2) the resulting allocation of compensation is reasonable, fair, and equitable from an actuarial perspective, and takes into account the proportional contribution to PLIC's surplus and asset valuation reserve of each class of policyholders. (Wagner testimony at pp. 232-33; Wagner opinion at p. 2.).

The record on this issue is extensive and persuasive: Allocation of the fixed and variable consideration components under the Plan is fair and equitable to PMHC policyholders.

(c) ***Effect of demutualization on PLIC and the closed block.*** As already noted, PLIC established the closed block in 1998 when it reorganized to an MIHC structure.

The closed block will remain unchanged by demutualization. (Article II of the Plan.). PLIC will continue to operate the closed block in accordance with its terms as originally

established in 1998. (McCarthy testimony at pp. 126-27.). Mr. Drury testified that no new PLIC policies will be added to the closed block because of demutualization. (Drury testimony at p. 43.).

Furthermore, PMHC has allocated assets to the closed block in amounts expected to produce cash flows which, taken together with anticipated surplus generated by the closed block policies, are expected to fund certain obligations and liabilities regarding these policies. (McCarthy testimony at p. 127; Article II of the Plan.). PMHC and Milliman have represented to the Division, in various disclosures and memoranda, that the amount allocated to the closed block is reasonably sufficient to support closed block business. Assets and surplus under the closed block policies will accrue solely to the benefit of policyholders until such time as the closed block ceases to exist. In addition, PMHC has represented to the Division through the March 19, 2001 letter of record, signed by PMHC's Senior Vice President and Chief Actuary, that pending proceedings against the company will have no effect on the closed block. (Hearing exhibit 16.).

The steps PMHC has taken to assure that demutualization will not adversely affect PLIC and the closed block are reasonable and appropriate. The Plan is fair and equitable to eligible policyholders in this respect.

(d) ***Fairness of the IPO price and reasonableness of the IPO process***. The IPO price refers to the price at which the common stock is offered to the public in the IPO. The IPO price – as well as the amount PFGI-DE ultimately receives from the IPO – will be determined by the market. However, the Plan contains important safeguards to ensure that the IPO price is fair and that the IPO

process is reasonable. Under section 5.2(e) of the Plan, the form, structure and terms of the IPO (including the IPO price) are subject to prior review and approval by the Commissioner. Section 5.2(f) requires, among other things, that (1) PMHC and PFGI-DE give the Commissioner and her advisors reasonable access to observe the IPO offering process, (2) PMHC and PFGI-DE must determine the IPO price through special pricing committees that will consist entirely of outside directors, (3) the terms of the underwriting agreement(s) must be acceptable to the Commissioner, and (4) PMHC and PFGI-DE must confirm to the Commissioner, at various points in the offering process, that they have complied with the Plan's requirements. Section 5.2 of the Plan also contains similar safeguards should PMHC and PFGI-DE decide to engage in one or more other capital raising transactions.

Two additional factors incorporated within the Plan accrue in favor of a fair IPO price: Under section 5.2 of the Plan, Commissioner approval of the Plan is effective for one year unless the Commissioner approves a longer period. This time frame allows PMHC flexibility to delay the IPO in the event of unfavorable market conditions. This timing flexibility ultimately accrues to the benefit of PMHC policyholders as well. In addition, under section 5.2 of the Plan, PMHC has the flexibility to raise capital through one or more other capital raising transactions. As a result, PMHC could meet the capital requirements of the Plan partially utilizing other securities rather than common stock. In certain situations, this could allow the company to offer less common stock and potentially receive a higher IPO price.

Whether the IPO process is properly conducted can only be determined after the closing date of the IPO. At that

juncture, the Commissioner will receive an opinion from Blackstone stating whether the procedures employed by the underwriters for the IPO in conducting the IPO pursuant to the Plan have been generally consistent with customary practices for IPOs, to the extent reasonably comparable to the IPO.

(e) ***Commission-free sales program***. The Plan includes the opportunity for eligible PMHC policyholders allocated less than 100 shares of consideration to participate in a commission-free sales program. Mr. Drury testified that inclusion of this provision is the standard approach taken in such situations. (Drury testimony at p. 70.). While it is unlikely that any eligible policyholders will be allocated less than 100 shares, provisions for this possibility in the Plan is fair and equitable to eligible policyholders.

The Commissioner has carefully considered all record evidence on the fairness and equity of the Plan vis-a-vis PMHC and its eligible policyholders. The few criticisms of the proposed demutualization raised during the course of the public hearing and through documents submitted by PMHC's policyholders, members of the public and others through the July 25 hearing date are sufficiently addressed and overcome by the Plan, the exhibits, the testimony and written submissions of PMHC's witnesses, and the testimony and written submissions of the Division's witnesses. The Plan and Iowa law contain sufficient safeguards to protect PMHC policyholders against the potential issues raised in written submissions and through hearing testimony. The record evidence consistently and substantially points to one finding: The Plan is fair and equitable to PMHC and its eligible policyholders.

C. THE REORGANIZED COMPANY WILL HAVE THE AMOUNT OF CAPITAL AND SURPLUS DEEMED BY THE COMMISSIONER TO BE REASONABLY NECESSARY FOR ITS FUTURE SOLVENCY.

Iowa Code section 508B.7 requires a plan to evidence that "the reorganized company will have the amount of capital and surplus deemed by the Commissioner to be reasonably necessary for its future solvency."

Mr. Drury projected that PFGI-DE will have consolidated equity of over $6 billion after demutualization. (Drury testimony at p. 55.). His estimation is confirmed by Unaudited Pro Forma Condensed Consolidated Statement of Financial Position on page 40 of Policyholder Information Booklet II. Based upon these facts and submissions and an analysis thereof, the Commissioner is satisfied that the reorganized company will have an amount of capital and surplus adequate to meet the statutory solvency requirement.

The Commissioner is also satisfied that PLIC's capital and surplus will be adequate following the demutualization of PMHC. PLIC is not underwriting demutualization expenses. Under the Plan, demutualization costs and funding of the cash and policy credits will be offset by the IPO proceeds and any other capital raising transactions completed on the effective date of the Plan.[9] (Drury testimony

[9] Other capital raising transactions may include private or public offerings of debt, additional common stock, preferred stock, or other sources of capital. (Drury testimony at p. 45.). The primary purpose of such transactions would be to fund PLIC policy credits and cash elections. (*Id.* at pp. 45-46.).

at p. 54.). As of March 31, 2001, PLIC had statutory capital and surplus in excess of $3 billion, and its total adjusted capital met the applicable risk-based capital requirements. (*Id.*). Mr. Drury and Ms. Shaff testified that demutualization should not have any adverse effect on PLIC's capital and surplus. (Drury testimony at pp. 54-55; Shaff testimony at p. 104). The company anticipates that PLIC will preserve its capital and surplus ratings post-demutualization. (Drury testimony at pp. 54-55.). The company also anticipates that PLIC's risk-based capital ratios will continue to meet all risk-based capital requirements after demutualization. (Drury testimony at p. 55.).

The Commissioner has carefully considered all testimony and comments elicited at the hearing, and all documents of record, whether or not specifically addressed above. The concerns expressed by PMHC's policyholders and members of the public at the hearing and through their written submissions through the date of the hearing are adequately addressed by the Application, the Plan and exhibits attached thereto, and the testimony and written submissions of PMHC's and the Division's witnesses.

Upon a careful review of the Application, the Plan and exhibits attached thereto, and the oral and written record submissions, the Commissioner finds there is substantial evidence that PMHC's policyholders would be benefitted by the adoption and implementation of the Plan. The Commissioner further finds that the Plan and the relevant provisions of the Iowa Code contain sufficient safeguards to protect against the potential issues expressed in written submissions and hearing testimony and comment.

V. CONCLUSIONS OF LAW

The legislature has vested discretion in the Commissioner not only to hold hearings and make factual findings, but also to interpret and apply the law. The Commissioner concludes, upon substantial record evidence, that the Plan of Conversion submitted by PMHC satisfies the Iowa Code requirements governing demutualizations. The Plan complies with all provisions of law, is fair and equitable to the company and its eligible policyholders, and the reorganized company will have the amount of capital and surplus deemed by the Commissioner to be reasonably necessary for its future solvency.

ORDER

IT IS THEREFORE ORDERED that:

The Plan of Conversion of Principal Mutual Holding Company, dated March 31, 2001, and the restructuring contemplated by the Plan are APPROVED on the condition that PMHC and PFGI-DE shall comply with the Plan's requirements in full (including, but not limited to, the Plan provisions governing the terms of the underwriting agreement, including the IPO size and price, the reasonableness of the IPO process, the size and terms of any other capital raising transactions, and any restrictions or limitations with respect to the company's equity compensation plans).

This Order shall be considered final agency action for the purposes of Iowa Code chapter 17A. Any action challenging the Plan or any part of the Plan shall comply with the

requirements of Iowa Code chapter 17A and Iowa Code section 508B.14.[10] Any application for rehearing shall comply with the requirements of Iowa Code sections 17A.16 and 508B.14. The Commissioner retains jurisdiction to the extent necessary to ascertain PMHC's and PFGI-DE's compliance with Plan requirements.

Dated this 28th day of August, 2001.

/s/ Therese M. Vaughan
THERESE M. VAUGHAN
Iowa Commissioner
of Insurance

[Service List Omitted]

[10] An action challenging the validity of a conversion plan, or any part of a conversion plan, shall not be commenced more than thirty days following the date of approval by the Commissioner, unless an application for rehearing is filed pursuant to section 17A.16, subsection 2. If an application for rehearing is filed, then such action must be filed within thirty days after that application is denied or deemed denied, or, if the application is granted, within thirty days after the issuance of the Commissioner's final decision on rehearing. Iowa Code § 508B.14.

No. 02-1551

Supreme Court, U.S.
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IN THE

Supreme Court of the United States

ESTHER L. GAYMAN,

Petitioner,

—v.—

PRINCIPAL FINANCIAL SERVICES, INC., PRINCIPAL FINANCIAL GROUP, INC. and PRINCIPAL LIFE INSURANCE COMPANY,

Respondents.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

BRIEF IN OPPOSITION

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QUESTIONS PRESENTED

The Court of Appeals held that the complaint, which asserted claims against a mutual insurance holding company and its corporate affiliates, properly was dismissed on the ground that it did not plead circumstances constituting state action, a required element of each of Petitioner's claims. The Petition purports to raise the following questions:

1. Was the decision of the Court of Appeals inconsistent with *Phillips Petroleum Co. v. Jenkins*, 297 U.S. 629 (1936)?

2. Was the decision of the Court of Appeals inconsistent with *Brown v. Legal Foundation of Washington*, 123 S. Ct. 1406 (2003)?

PARTIES AND CORPORATE DISCLOSURE STATEMENT

All of the parties to the proceeding below are listed in the caption. Respondent Principal Financial Group, Inc. is the corporate parent of Respondent Principal Financial Services, Inc., which is the corporate parent of Respondent Principal Life Insurance Company. There is no other parent or publicly held company owning 10% or more of a Respondent's stock.

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STATEMENT OF THE CASE

This action challenged the Plan of Conversion (the "Plan") of Principal Mutual Holding Company ("PMHC"). Under the Plan, PMHC changed its form of corporate organization from a mutual insurance holding company to a stock company, a process known as demutualization. The Plan was adopted unanimously by the board of directors of PMHC on March 31, 2001. App. 66, 79. It was overwhelmingly approved by over 92% of voting policyholders of Principal Life Insurance Company ("Principal Life"), who were the members of PMHC, in a policyholder vote on July 24, 2001. App. 67. Following a public hearing, the Plan also received the approval of the Commissioner of Insurance of the State of Iowa on August 28, 2001. App. 65-95. The Plan became effective on October 26, 2001.

The purpose of the Plan was to strengthen the Principal organization by providing flexibility to raise additional capital. App. 2, 71-72. Under the Plan, eligible policyholders such as Petitioner received compensation representing 100% of the value of PMHC in the form of common stock, cash or policy credits in exchange for their membership interests in PMHC. App. 85-86.[1]

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[1] PMHC was originally formed in a 1998 transaction, which was not challenged in this action. In the 1998 transaction, Principal Life converted from an Iowa mutual life insurance company to an Iowa stock life insurance company operating within a mutual holding company structure. App. 1, 65. As a result of the 1998 transaction, Principal Life became an indirect wholly owned subsidiary of PMHC, which was an Iowa mutual holding company controlled by Principal Life's policyholders. App. 1-2. In the 2001 *(continued)*

Petitioner commenced this action in the United States District Court for the Northern District of Illinois, Western Division, on September 27, 2001. The complaint purported to assert claims against Respondents and related corporate entities (together, the "Principal Defendants") pursuant to 42 U.S.C. § 1983 for alleged violations of the Takings Clause, the Contracts Clause and the Commerce Clause arising from PMHC's adoption of the Plan.[2] Petitioner contended that the Principal Defendants were "state actors" and acted "under color of state law" in adopting and implementing the Plan, on the grounds that state law authorized the conversion and the Plan was approved by the Commissioner. App. 42, 46, 47.

The Principal Defendants moved to dismiss the complaint on the ground that (i) the conduct of the Principal Defendants challenged in the complaint did not amount to state action, and (ii) the complaint failed to state an actionable claim even if Petitioner could satisfy the state action requirement. On April 16, 2002, the District Court

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demutualization, PMHC converted into a stock company and, together with certain intermediate holding companies, merged with and into Respondent Principal Financial Services, Inc. ("PFS"), a newly formed holding company. App. 68. Respondent Principal Financial Group, Inc., a newly-formed, publicly-traded holding company, became the parent company of PFS. *Id.*

[2] In addition to the corporate entities named in the caption of the Petition, the complaint named PMHC and several other affiliates as defendants. App. 31. These additional entities no longer have any separate legal existence, as they merged into Principal Financial Services, Inc. under the Plan. App. 2, 68; *see* Iowa Code § 490.1106(1)(d) (suit against corporation extinguished in merger may proceed against surviving corporation).

granted the motion to dismiss, App. 5-8, ruling that the complaint "fails the state action requirement and . . . must therefore be dismissed." App. 8. In particular, the District Court observed that under settled law, "'[a]ction taken by private entities with the mere approval or acquiescence of the State is not state action.'" App. 6 (quoting *American Mfrs. Mut. Ins. Co. v. Sullivan*, 526 U.S. 40, 52 (1999)).

Petitioner appealed to the United States Court of Appeals for the Seventh Circuit. After briefing and argument, the Seventh Circuit affirmed the judgment of the District Court on November 22, 2002. In a unanimous opinion written by Judge Easterbrook, the panel held that the complaint failed the state action requirement. App. 1-4. Quoting from and citing settled authority of this Court, the Seventh Circuit emphasized "that 'a business is subject to state regulation does not by itself convert its action into that of the State for purposes of the Fourteenth Amendment.' . . . Nor does the need to obtain approval turn private action into public action." App. 3 (quoting *Jackson v. Metropolitan Edison Co.*, 419 U.S. 345, 350 (1974); citing *American Mfrs., supra*; *Blum v. Yaretsky*, 457 U.S. 991 (1982); and *Flagg Bros. v. Brooks*, 436 U.S. 149 (1978)). The court further observed that the challenged transaction was initiated by a private company, adopted by its board of directors and approved by its policyholders. App. 4. The court rejected Petitioner's attempt to constitutionalize a company's decision to change its corporate form. The court stated:

> All corporate management is subject to control under state law (including judicial review of managers' competence and loyalty); some decisions require advance approval; yet it would be

> preposterous to say that all corporate acts therefore are state acts.

App. 3-4.

Petitioner sought both panel rehearing and rehearing en banc. The petition was denied, as all the judges on the panel voted to deny rehearing, and no judge in regular active service called for a vote on rehearing en banc. App. 9.

Petitioner then sought and obtained an extension of time to file this petition for certiorari, in order for it to coincide with the petition for certiorari in *Tancredi v. Metropolitan Life Insurance Co.*, No. 01-1542. *Tancredi* involved similar claims against another company brought by the same lawyers, and its dismissal had recently been affirmed by the Second Circuit. *See Tancredi v. Metropolitan Life Ins. Co.*, 316 F.3d 308 (2d Cir. 2003). The petitions for certiorari in this case and in *Tancredi* were both filed on April 21, 2003.

REASONS FOR DENYING THE WRIT

There is nothing remarkable about the decision below, which flows obviously and directly from this Court's settled case law on the requirement of state action. Petitioner's contention that the case is inconsistent with *Phillips Petroleum Co. v. Jenkins*, 297 U.S. 629 (1936), and *Brown v. Legal Foundation of Washington*, 123 S. Ct. 1406 (2003), is frivolous. *Phillips Petroleum* did not even involve the issue of state action. Moreover, *Phillips Petroleum* and *Brown*, unlike the present case, involved challenges to state laws that imposed mandatory obligations on private conduct. Here, however, Petitioner challenged a privately initiated and implemented transaction that

was merely permitted under state law. Under this Court's settled precedent, mere permission by the state does not transform private conduct into state action.

In any event, if Petitioner genuinely believed that the Plan did not provide adequate compensation, ample remedies were available under state law. No constitutional issues are implicated.

I.
The Decision Below Raises No Issues Warranting This Court's Review, As It Follows Directly from This Court's Settled Precedent on the Issue of State Action.

The decision below raises no question of federal law that has not been settled by this Court. Rather, the decision follows easily from a straightforward application of this Court's precedents on the state action requirement.

The complaint purports to state claims under 42 U.S.C. § 1983 for violation of the Takings Clause of the Fifth Amendment as applied to the states by the Due Process Clause of the Fourteenth Amendment, and for violation of the Contracts Clause of Article I, § 10.[3] A necessary element of each of these claims is "state action," which requires that the alleged constitutional deprivation be undertaken by a "state actor." *See, e.g., American Mfrs. Mut. Ins. Co. v. Sullivan*, 526 U.S. 40, 50 (1999) (under Fourteenth Amendment, state action requires that

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[3] The Complaint also purported to raise Commerce Clause claims, which also require state action, but Petitioner does not raise those claims in the Petition.

the alleged constitutional deprivation be undertaken by a "state actor"); *Blum v. Yaretsky*, 457 U.S. 991, 1002 (1982) (Fourteenth Amendment "erects no shield against merely private conduct"); *Rendell-Baker v. Kohn*, 457 U.S. 830, 838 (1982) ("under color of law" requirement of 42 U.S.C. § 1983 means "the same thing as the 'state action' required under the Fourteenth Amendment"); U.S. Const., Art. I, § 10 ("No *State* shall . . . pass any . . . Law impairing the Obligation of Contracts") (emphasis added); *see also Brown*, 123 S. Ct. at 1421 (rejecting Takings Clause claim to extent alleged taking resulted from private action rather than state action).

Petitioner cannot satisfy the state action requirement because the Principal Defendants are private entities and not state actors. The starting point for the analysis of allegations of state action is to "identif[y] the specific conduct of which the plaintiff complains"—here, the adoption and implementation of the Plan. *American Mfrs.*, 526 U.S. at 51. Petitioner's claims plainly fail because that purely private decision is not "fairly attributable to the state," *id.* at 50, as the Court of Appeals correctly recognized.

Petitioner seeks to characterize the adoption and implementation of the Plan as state action because it was authorized by state law and received regulatory approval. As this Court expressly has held, however, "[a]ction taken by private entities with the mere approval or acquiescence of the State is not state action." *American Mfrs.*, 526 U.S. at 52; *accord, e.g., Blum*, 457 U.S. at 1004 ("Mere approval of or acquiescence in the initiatives of a private party" pursuant to statute does not transmute that private initiative into state action); *Jackson v. Metropolitan Edison Co.*, 419 U.S. 345, 357 (1974) (approval by state

agency of private company's business decision "does not transmute" that private initiative into state action). The Plan was proposed by PMHC's management, adopted unanimously by PMHC's board of directors, approved by a vote of PMHC's members, and implemented by PMHC and the other Principal Defendants through an initial public offering and the distribution of consideration to PMHC's members. In holding that the state action requirement was not satisfied, the Court of Appeals reached the only conclusion possible under this Court's settled precedents. App. 3-4; *see, e.g., American Mfrs.*, 526 U.S. at 52 (test is whether state "has exercised coercive power or has provided such significant encouragement, either overt or covert, that the choice must in law be deemed to be that of the State").

Petitioner misstates the holding of *Lugar v. Edmondson Oil Co.*, 457 U.S. 922, 937 (1982), in arguing that state action is established merely by showing that the defendant has exercised a right or privilege created by the state. Pet. 9. In fact, *Lugar* holds that *in addition* to the exercise of a right or privilege created by the state, state action also requires that

> the party charged with the deprivation must be a person who may fairly be said to be a state actor. This may be because he is a state official, because he has acted together with or has obtained significant aid from state officials, or because his conduct is otherwise chargeable to the State. Without a limit such as this, private parties could face constitutional litigation whenever they seek to rely on some state rule governing their interactions with the community surrounding them.

Id. at 957; *see also Flagg Bros. v. Brooks*, 436 U.S. 149, 156 (1978) (warehouse operator's sale of plaintiff's goods, though authorized by statute, was not state action).

Petitioner's attempt to portray a private corporation's decision to reorganize as an exercise of the state's "reserved power," Pet. 9, also is insufficient to establish state action under the settled precedent of this Court. To establish state action on the ground that a private entity is exercising a state function, a plaintiff must show that the private entity is exercising core governmental functions that are "the *exclusive* prerogative of the State." *Rendell-Baker*, 457 U.S. at 842 (quoting *Jackson*, 419 U.S. at 353 (emphasis added by Court)) (holding that education of special-needs children was not state action under "public function" theory, even when funded by state); *see also Blum*, 457 U.S. at 1011 (same, with regard to nursing home receiving public funds). Private decisions regarding the organization of private corporations, though authorized by state law, do not fall into this very narrow category. As the Court of Appeals recognized, "[t]oday anyone can incorporate and mergers may be approved by majority vote." App. 4; *see also Tancredi*, 316 F.3d at 313 ("The management of a corporation is not a public function; and a state's permission of a corporation to organize itself in a particular manner is not the delegation of governmental authority"). The decision to undertake such private corporate changes is not even the type of decision that the state commonly makes, much less a decision that is inherently the exclusive prerogative of the state. *See Blum*, 457 U.S. at 1011; *Rendell-Baker*, 457 U.S. at 842; *Jackson*, 419 U.S. at 352-53.

II.
The Decision Below Does Not Conflict With Any Decision of Another Federal Court of Appeals or of This Court.

Petitioner's suggestion that there is a conflict among the federal Courts of Appeals on the state action issue in this case, Pet. 4, is incorrect. Every federal Court of Appeals to have considered the question has concluded that a corporate reorganization, where authorized by statute but initiated by the corporation itself, does not constitute "state action" or "governmental action" under this Court's precedents. *See Cranley v. National Life Ins. Co.*, 318 F.3d 105, 111-13 (2d Cir. 2003); *Tancredi*, 316 F.3d at 312-14; *Broad v. Sealaska Corp.*, 85 F.3d 422, 430-31 (9th Cir. 1996); *Ordower v. Office of Thrift Supervision*, 999 F.2d 1183, 1187 (7th Cir. 1993); App. 1-4. Although Petitioner claims that these cases conflict with *Ohio State Life Insurance Company v. Clark*, 274 F.2d 771 (6th Cir. 1960), the *Clark* case did not consider or address the issue of state action. Review by this Court is unnecessary in view of the unanimity of the federal Courts of Appeals that have considered this point, and the absence of any difficult question of law.

Petitioner also has no basis for the assertion that the decision below "disregard[ed] as outdated" this Court's decision in *Phillips Petroleum Co. v. Jenkins*, 297 U.S. 629 (1936), or construed subsequent cases as "*sub silentio* overruling" the *Phillips Petroleum* decision. Pet. i. In fact, the opinion of the Court of Appeals does not even cite *Phillips Petroleum*, which has no bearing on the issue of state action.

Phillips Petroleum involved a challenge to the constitutionality of a state statute imposing liability on corporations for injuries sustained by their employees as a result of the negligence of co-employees. The Court held that this law, which "substitutes the rule of respondeat superior for the common-law fellow-servant rule," was reasonably related to government interests and consistent with both the Contracts Clause and the Equal Protection Clause. 297 U.S. at 636. As part of its ruling, the Court observed that the state's reserved power to amend laws affecting corporations defeated the petitioner's Contracts Clause claim. *Id.* at 634. The Court also noted that "[t]he reserved power is not unlimited and cannot be exerted . . . to take property without compensation." *Id.*

Contrary to the impression Petitioner attempts to create, Pet. 10, the presence of state action was not in dispute in *Phillips Petroleum*. Moreover, that case involved the mandatory imposition of liability by state law. Here, in stark contrast, Petitioner challenged a corporate decision initiated and implemented by a private corporation. As this Court's cases make clear, a private decision to exercise a right granted by statute is not "state action," absent coercion or significant encouragement that demonstrates that the decision is attributable to the state. *See, e.g., American Mfrs.*, 526 U.S. at 52.[4]

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[4] For similar reasons, Petitioner's reliance on *Coombes v. Getz*, 285 U.S. 434 (1932) and *Looker v. Maynard*, 179 U.S. 46 (1900), is misplaced. Like *Phillips Petroleum*, neither of those cases arose under 42 U.S.C. § 1983, and neither of them addressed the issue of state action.

Accordingly, Petitioner cannot satisfy the state action requirement. The *Phillips Petroleum* language cited by Petitioner addresses only substantive restrictions that the Takings Clause or Contracts Clause places on actions taken *by the state*. That language is irrelevant where, as here, a private party has initiated and undertaken the challenged conduct. Petitioner's claim of a "direct conflict" between *Phillips Petroleum* and the decision below is therefore baseless.

For similar reasons, Petitioner's assertion that the decision below conflicts with this Court's decision in *Brown v. Legal Foundation of Washington*, 123 S. Ct. 1406 (2003), is completely meritless. In *Brown*, the Court rejected a challenge to a Washington state-court rule, which required certain escrowed funds to be held in an account subject to the state's "interest on lawyers' trust accounts" ("IOLTA") program, if the funds could not generate net interest for the client's benefit. The interest on the IOLTA account was paid to a foundation for public purposes. *See* 123 S. Ct. at 1421. The Court "*assume[d]* that . . . [petitioners'] interest was taken for a public use" under this procedure. *Id.* at 1419 (emphasis added). The Court concluded, however, that the petitioners lost nothing of value, because the IOLTA rules applied only when the funds could not generate net interest for their owner. *Id.* at 1419-20. The Court held, therefore, that the amount of "just compensation" was zero. *Id.*

Petitioner's reliance on the assumption in *Brown* that a taking had occurred has no bearing on the issues in this case, because the mandatory IOLTA requirement in *Brown*—unlike PMHC's decision to demutualize—clearly involved state action. In *Brown*, the State of Washington *required* all lawyers and limited practice officers ("LPOs")

to place escrowed funds in IOLTA accounts whenever they determined that the funds could not generate net interest for the client. Here, by contrast, the state has not required any company to demutualize. As described above, PMHC's demutualization was initiated by its management, adopted by its board of directors and approved by a policyholder vote. PMHC was entirely free not to pursue a conversion under the demutualization statute if it so chose.[5]

As *Brown* itself makes clear, action that would violate the Takings Clause if undertaken by the state raises no constitutional concern if it is undertaken by a private party. Indeed, the petitioners in *Brown* argued that the IOLTA rule might cause lawyers or LPOs to deposit funds in IOLTA accounts mistakenly, even if the funds could generate net income. *Id.* at 1420. The Court, however, rejected the notion that this amounted to a Takings Clause violation, holding that the likelihood of erroneous deposits by private actors did not undermine the validity of the IOLTA process created by the state. *Id.* at 1421. The Court observed:

> The [Washington State IOLTA] Rules . . . unambiguously require lawyers and LPOs to deposit client funds in non-IOLTA accounts whenever those funds could generate net earnings for the client. . . . Thus, if the LPOs who deposited petitioners' money in IOLTA accounts could have

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[5] For the same reason, the remaining Takings Clause cases cited by the Petitioner (Pet. 13-15), which presuppose coercion by the state, are inapposite.

> generated net income, the LPOs violated the court's Rules. Any conceivable net loss to petitioners was the consequence of the LPOs' *incorrect private decisions rather than any state action.*

Id. (emphasis added).

Here, too, any claim by the Petitioner that compensation distributed by PMHC under the Plan was inadequate was not the result of any action by the state. The Plan was a privately initiated and implemented decision. Moreover, Iowa's laws regulating demutualization are designed to require that policyholders receive adequate compensation, and provide that any plan of demutualization must be "fair and equitable to policyholders." Iowa Code § 508B.3. Accordingly, as with the mistaken IOLTA deposits addressed in *Brown*, any conceivable harm to policyholders from an allegedly unfair demutualization would be the result of the demutualizing company's putatively "incorrect private decisions, rather than any state action." *Brown*, 123 S. Ct. at 1421. For this reason, Petitioner has no viable constitutional claim.

III.
Policyholders' Interests Are Fully Protected by State Law.

Finally, Petitioner's assertion that the decision below "affect[s] significant and valuable property rights," Pet. 16, is incorrect. Even putting aside the widely recognized fact that membership interests in a mutual organization lack tangible economic value in the absence of a demutu-

alization,[6] state law governing demutualizations amply protects any interests that policyholders may have.

Any policyholder who believed that the Plan failed to provide fair and equitable compensation in exchange for policyholders' membership interest, or otherwise failed to meet the applicable legal requirements, had an opportunity to object to the Plan orally or in writing at a public hearing before the Commissioner. App. 78; *see also* Iowa Code §§ 508B.7, 508B.8. Furthermore, any policyholder who believed the Plan was improperly approved could have sought judicial review in state court. *See* Iowa Code § 508B.14; *see also* App. 2 (Seventh Circuit opinion, noting that "[d]issenting policyholders . . . might have asked the state courts to review the transaction for compliance with state law but did not").

Petitioner's suggestion that policyholders were somehow denied justice is therefore completely unfounded. The matters of corporate organization that Petitioner challenges are entrusted to the business judgment of the company's board of directors and to the judgment of the

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[6] *See, e.g., Paulsen v. Commissioner*, 469 U.S. 131, 138-40 (1985) (value of membership interests in mutual savings bank was "practically, zero"); *Society for Savings v. Bowers*, 349 U.S. 143, 150 (1955) (same); *Tancredi v. Metropolitan Life Ins. Co.*, 149 F. Supp. 2d 80, 86-87 & n.22 (S.D.N.Y. 1991) (citing cases holding that mutual company membership interests, whether in insurance company or savings bank, are "too insubstantial" to constitute property), *aff'd*, 316 F.3d 308 (2d Cir. 1993), *petition for cert. filed*, 71 U.S.L.W. 3699 (U.S. Apr. 21, 2003) (No. 02-1542). Petitioner's contractual rights in her insurance contract are expressly preserved by the Plan and are unimpaired as a matter of law. *See* Iowa Code § 508B.9.

voting policyholders, subject to regulation by the state for policyholders' protection. No issues of federal law warranting this Court's attention are implicated.

CONCLUSION

For all of the foregoing reasons, Respondents respectfully request that the Court deny the Petition.

Respectfully submitted,

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On Petition For A Writ Of Certiorari To The United States Court Of Appeals For The Seventh Circuit

REPLY BRIEF IN SUPPORT OF THE PETITION FOR WRIT OF CERTIORARI

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INTRODUCTION

The Brief of Respondents ("Principal") serves to further demonstrate the importance of the question presented. The Petition argues that this Court's specific "reserve power" decision in *Phillips Petroleum v. Jenkins,* 297 U.S. 629, 634 (1936) and the specific *per se* Takings Clause analysis of *Brown v. Legal Foundation of Washington,* 123 S.Ct. 1406 (2003) apply to determine whether a mutual insurer acts as a "state actor" under 42 U.S.C. § 1983 in violation of the Takings and Contracts Clauses in a statutory demutualization.

Principal argues that the Seventh Circuit correctly applied general, non-Takings Clause state action precedent derived from *American Manufacturers v. Sullivan,* 526 U.S. 40 (1999); *Blum v. Yaretsky,* 457 U.S. 992 (1982) and *Rendell-Baker v. Kohn,* 457 U.S. 830 (1982), and that *Phillips* and *Brown* are irrelevant. The Second and Fifth Circuits held the same in cases in which Petitions For Certiorari are now pending before this Court. *Tancredi v. Metropolitan Life,* No. 02-1542 and *Campbell v. John Hancock,* No. 02-1681. The decisions of the Second, Fifth and Seventh Circuits appear to conflict with the Sixth Circuit's decision in *Ohio State Life Insurance Co. v. Clark,* 274 F.2d 771 (6th Cir. 1960) as well as this Court's decisions in *Phillips Petroleum* and *Brown.*

Because of the present conflict and the widespread importance of the question presented affecting the property rights of millions of mutual policyholders, it is respectfully submitted that this Court grant Certiorari.

I. The Brief In Opposition Demonstrates A Substantial Conflict As To Whether The State Action Question Is Subject To Specific Takings And Contracts Clause Precedent Applicable To Corporate Reorganizations Or More General Fourteenth Amendment Due Process State Action Precedent

As this Court has observed, ". . . if a precedent of this Court has direct application in a case, yet appears to rest on reasons rejected in some other line of decisions, the lower courts should follow the case which directly controls, leaving to this Court the prerogative of overruling its decisions." *Rodriquez de Ouijas v. Shearson/American Express,* 490 U.S. 477, 484 (1989).

Principal argues that the Seventh Circuit correctly found no state action because the state did not mandate or coerce the decision to demutualize. *Cf.* App. A, p. 3; Principal Br. at pp. 4-6. This Court's *specific* Takings Clause precedent demonstrates, instead, that state action is present where a permanent physical occupation of another's property is "authorized" or "merely permitted" by the government after request by the person seeking to take the property. *Loretto v. Teleprompter Manhattan CATV Corp.,* 458 U.S. 419, 426 (1982). In *Loretto,* the state neither mandated nor coerced the cable company to occupy the property owners' rooftops. Instead, the cable company freely elected to occupy that property based upon the power and procedures in the state enabling act. *Id.* at 424. That the cable company in *Loretto* conducted itself as a "state actor" was unquestionable.

Under specific *per se* Takings case precedent, unlike the Fourteenth Amendment due process cases cited by Principal and the Seventh Circuit (Principal Br. at pp. 4-6),

the question is not whether the State "mandates" an actor to deprive another of property without notice or opportunity to be heard, *but rather whether the State has "enabled" or "authorized" the actor to cause an involuntary transfer of private property to another.* What was "mandated" or "coerced" in *Loretto* was the apartment owners' "forced acquiescence" to the occupation by the cable company. *See Yee v. City Of Escondido,* 503 U.S. 519 (1992). Here, what was "coerced" was the policyholders' forced relinquishment of their contractual rights. The fact that the decision to demutualize was voluntary is irrelevant, just as it is irrelevant that the cable company in *Loretto* voluntarily chose to utilize state created powers to take rooftop space. Because Principal allegedly used the state conversion law to "force" policyholders to give up their contractual interests, Principal exercised "state action" within the meaning of the Takings and Contracts Clauses.

It is respectfully submitted that whether Principal exercised "state action" and engaged in a *per se* Taking of property are important federal constitutional questions upon which this Court should grant Certiorari.

II. Respondents' State Remedies Defense Is Erroneous Under This Court's Precedent

Petitioner is not required to exhaust all other potential state remedies, as Principal now contends, in order to obtain damages under the Takings Clause. The lower courts properly addressed the merits. App. A, p. 3; B, p. 15. Although not raised in the court below, Principal suggests that a Takings claimant must exhaust all state remedies before resorting to the compensation remedy in the Takings

Clause. This Court rejected this argument in *Williamson County v. Hamilton Bank of Johnson City*, 473 U.S. 172 (1985), explicitly ruling that "exhaustion of *review procedures*" was not required, citing *Patsy v. Florida Board of Regents*, 457 U.S. 496 (1982). *Id.* at 195, n.13.

Principal is wrong to argue that Iowa corporate legal protections are exclusive. The Takings Clause guarantees a *compensation* remedy for a Taking; therefore, making any state law remedy merely supplementary. *First English Evangelical Church of Glendale v. County of Los Angeles, California*, 482 U.S. 304, 314-15 (1987); *Jacobs v. United States*, 290 U.S. 13, 27 (1933). As the Fourth Circuit in *Washlefske v. Winston*, 234 F.3d 179 (4th Cir. 2000) succinctly recognized, supplementary state remedies cannot subvert the remedy specifically guaranteed by the Takings Clause in stating:

> If we were, in this circumstance, to require Washlefske to file his claim first in a Virginia court, we would be transforming *Williamson County's* finality rule into a rule of exhaustion. This result would be in diametric opposition to a foundational decision of modern § 1983 jurisprudence, *Monroe v. Pape*, which held that "the federal remedy is supplementary to the State remedy, and the latter need not be first sought and refused before the federal one is invoked." 365 U.S. 167, 183 (1961).

234 F.3d at 183.

Williamson provides for a "prudential ripeness" rule of finality which was automatically satisfied here by the Commissioner's decision which authorizes the Taking and sets the amount of or method for determining the compensation to be made pursuant to the procedure in the Conversion

Law. App. G. *See also Suitum v. Tahoe Regional Planning*, 520 U.S. 725, 734 (1997). Further exhaustion of review procedures was not required. Review here was conditioned upon the plaintiff posting security for Principal's attorneys' fees, a condition most policyholders could not afford. App. 27. Petitioner naturally elected to pursue the unconditional remedy under the Takings Clause.

Under this rule of finality, once a state has determined to authorize a Taking *and* the designated state official has determined the amount of compensation, if any, that will be paid, a Takings Clause claim is ripe. In this sense, in a *per se* or "physical occupation" Takings case, ripeness exists as a matter of law when the property is transferred by government authority and the amount of compensation, if any, has been determined. *Washlefske v. Winston*, 234 F.3d 179, 183 (4th Cir. 2000). The Fourth Circuit in *Washlefske* explained that *Williamson* requires a determination as to whether a final decision by the state has been made authorizing a Taking *and* deciding the value of compensation, if any, to be paid:

> In this case, the finality of the State's position has not been questioned; the statute's language is clear and its impact upon Washlefske is uncontroverted . . . Not only is the State's use of the interest uncontroverted, but also its amount is readily calculable, more than satisfying the Supreme Court's prudential ripeness requirements.

Id. at 182-83. *See also Montgomery v. Carter County, Tennessee*, 226 F.3d 758, 765 (6th Cir. 2000) ("In holding that the tract owner's claim was not ripe, the Supreme Court took pains to distinguish the concept of finality from the somewhat related but distinct concept of exhaustion of state remedies"). By the Commissioner's order, the State

made a final decision allowing Petitioner to then pursue her Takings Clause compensation remedy.

Other circuit courts hold that *Williamson* provides a "rule of exhaustion." *Deniz v. Municipality of Guaynabo,* 285 F.3d 142, 146 (1st Cir. 2001) and *Daniels v. Area Plan Commission Of Allen County,* 306 F.3d 445, 453 (7th Cir. 2002). The question whether *Williamson* provides for a rule of finality or a rule of exhaustion is presented in the related Petition For Certiorari in *Campbell v. John Hancock,* No. 02-1681, filed on May 16, 2003.

CONCLUSION

Wherefore, it is respectfully requested that this Honorable Court accept Certiorari here and in the related cases of *Tancredi v. Metropolitan Life,* No 02-1542 and *Campbell v. John Hancock,* No. 02-1681, in which Petitions For Writ of Certiorari are pending, to address these important constitutional questions.

Respectfully submitted,

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